

Vol. VIII
TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1942

No. 721

THE NORTH AMERICAN COMPANY, PETITIONER,

vs.

SECURITIES AND EXCHANGE COMMISSION

**WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SECOND CIRCUIT**

PETITION FOR CERTIORARI FILED FEBRUARY 10, 1943.

CERTIORARI GRANTED MARCH 1, 1943.

United States Circuit Court of Appeals

FOR THE SECOND CIRCUIT

October Term, No. 721

THE NORTH AMERICAN COMPANY,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

TRANSCRIPT OF RECORD

TESTIMONY

Volume VIII

(Pages 2872 to 3238)

ON PETITIONS FOR REVIEW OF ORDERS OF SECURITIES
AND EXCHANGE COMMISSION.

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8614

BEFORE THE

Securities and Exchange Commission


Docket No. 59-10

IN THE MATTER

of

THE NORTH AMERICAN COMPANY, *et al.*

8615



Hearing Room 1101,
Securities and Exchange Commis-
sion Building,
18th & Pennsylvania Avenue,
N. W.,
Washington, D. C.,
Tuesday, April 8, 1941.

Met, pursuant to adjournment, at 10:00 o'clock, a. m.

8616 Before: WILLIAM W. SWIFT, *Trial Examiner*.

Appearances:

S. PEARCE BROWNING, JR., and

CHARLES S. HAMILTON, JR., of Sullivan & Cromwell, 48
Wall Street, New York City, New York, appearing for
The North American Company, et al., Respondents.

RALPH C. BINFORD, appearing for the Securities and Ex-
change Commission.

Herbert C. Freeman—By Respondents—Direct

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(10:15 a.m.)

PROCEEDINGS

The Examiner: The hearing will come to order.

Whereupon, HERBERT C. FREEMAN, called as a witness on behalf of the Respondents, having previously been sworn, resumed the stand and testified further as follows:

Direct Examination by Mr. Hamilton (Continued):

8618

Q. Mr. Freeman, have you any data as to the distribution of stockholders of The North American Company at a recent date? A. As of December 31, 1940, there were 73,131 stockholders, distributed among the various classes of stock as follows: 9,322 shareholders of 6 per cent. preferred; 6,124 holders of $5\frac{3}{4}$ per cent. preferred; and 57,685 holders of common stock.

Q. Now, as to the numerical distribution of the stock of the company, have you any figures to indicate whether or not it has changed or remained unchanged over a period of years? A. It has remained relatively unchanged over recent years.

8619

Of the holders of 6 per cent. preferred stock, in March, 1935, 91 per cent. held 100 shares or less, and at the end of

—6,967—

1939, 90.6 per cent. held 100 shares or less; and of the holders of common stock, in March, 1935, 84.4 per cent. held 100 shares or less, and at the end of 1939, 85 per cent. held 100 shares or less.

8620

Herbert C. Freeman—By Respondents—Direct

Q. Have you any data to indicate the geographical character of the distribution of stock? A. The latest analysis we had by geographical distribution was in March, 1938, and at that time there were holders of common stock in every state, and holders of the 6 per cent. preferred stock in every state but Nevada, and there were also holders of both classes in the District of Columbia, in Alaska, the Canal Zone, Hawaii, the Philippines, Puerto Rico and the Virgin Islands.

8621

Q. Now, as to the type of security holder, has any analysis ever been made along this line? A. In March, 1941, we had some examination made of the types of holders. We have not had a complete analysis made for several years, but the distribution at that time showed many holdings among insurance companies, trustees, guardians, executors, educational and religious institutions and fraternal organizations.

8622

Q. Did it apply to all classes of stock or one class? A. This applied both to common and preferred stock. For example, there was one life insurance company which owned 103,709 shares of common stock and 4,000 shares of 5¾ per cent. preferred stock, and another insurance company

—6,968—

which owned 35,000 shares of 5¾ per cent. preferred stock, and another insurance company owned 15,000 shares of common stock and 6,700 shares of 6 per cent. preferred stock, and numerous other life, fire and casualty insurance companies owned preferred stock and common stock in lots ranging from 500 shares to 5,000 shares.

A number of large universities hold shares of preferred and common stock. One university owned 4,100 shares of

6 per cent. preferred stock and 7,000 shares of common stock, and another university owned 6,000 shares of $5\frac{3}{4}$ per cent. preferred stock and 2,519 shares of common stock.

We had an analysis made in December, 1940, to determine the number of common stockholders—or rather the number of shares of common stock registered in the name of banking institutions as trustees or co-trustees, and we found there were at the time out of 8,572,626 shares outstanding in the hands of the public, 463,592 shares registered in the names of 326 banking institutions as trustees or co-trustees for 1,296 trust accounts.

8624

Q. Now, have you caused an analysis to be made of the stock distribution of the Cleveland Electric Illuminating Company? A. Yes, I have been furnished by that company with figures relating to the holdings by stockholders other than The North American Company as of March 15, 1941.

—6,969-70—

Q. And what does that analysis disclose as to holdings within the service territory of the Cleveland Electric Illuminating Company? A. The analysis shows that out of 2,178 holders of record of the 2,324,564 shares of its common stock, there were 346 holders of record owning 31,109 shares who were residents of the territory served by the company.

8625

Q. Those are holdings of record, are they not? A. Holdings of record, yes.

Q. And your figure applies to the common stock of—

A. (Interposing) That relates to common stock.

The holdings in the territory represent 1.3 per cent. of the total number of shares outstanding.

Now, as to the preferred stock, there are in all 4,300 holders of record of the 254,989 shares of preferred stock

8626

Herbert C. Freeman—By Respondents—Direct

outstanding, and of those, 1,201 holders of record were residents of the territory served by the company, and they held 60,159 shares, or 23.6 per cent. of the total number of shares of preferred stock outstanding.

Q. These, again, are record holdings, are they? A. Yes, those are record holdings.

Q. At the same date previously specified? A. Yes, sir.

Q. Now, have you had a somewhat similar analysis made

—6,971—

8627

of the distribution of common stock of the Detroit Edison Company in the state of Michigan? A. Yes, sir, I have been furnished with an analysis of the shares outstanding as of February 28, 1941.

Q. And what does that analysis disclose? A. That shows that of the total number of shares outstanding, that is, 1,272,260 shares, there are held by stockholders who are holders of record resident in the state of Michigan, a total of 288,405 shares, which represent 22.6 per cent. of the total number of shares outstanding.

8628

Q. Now, in order to make your statement clear, I understand that as to Detroit Edison the figure relates to the entire state and is not confined solely to the service territory of the Detroit Edison Company? A. That is correct.

Q. May I ask you, Mr. Freeman, whether you know approximately how long in each case, that is, in the case of the Cleveland Company and in the case of Detroit Edison, securities, common stock, of those companies has been outstanding with the public? A. In the case of the Detroit Company, the present company was organized, I believed, in 1902, or early in 1903.

Herbert C. Freeman—By Respondents—Direct

8629

In the case of the Cleveland Electric Illuminating Company, I believe it has had securities outstanding with the public for 50 years. —6,972—

Q. And as to Detroit Edison, have securities, common stock, of that company been outstanding with the public since date of organization? A. Yes, sir.

Q. The Respondents' Exhibit 125 contains a table showing certain advances made by North American to various of its subsidiaries. Would you illustrate the nature and purpose of the more important of those advances?

8630

Mr. Binford: What page of the exhibit is that?

Mr. Hamilton: The table I refer to is page 68 of the exhibit.

The Witness: The table, I might mention, is somewhat limited in this respect, that it only shows the maximum balance due by the subsidiary companies to any or all of the three holding companies; The North American Company, the Wisconsin Edison Company, and North American Edison Company, in any year in which there was a balance owing by that subsidiary to those companies for more than six months during the year.

8631

By Mr. Hamilton:

Q. In other words—— A. (Interposing) So that certain advances that were made for particular purposes which were repaid within a comparatively short time do not appear on that schedule.

Q. Repaid within six months? A. Yes.

—6,973—

8632

Herbert C. Freeman—By Respondents—Direct

These advances have been made by The North American Company and by these two other holding companies to the subsidiaries over a long period of years, for the purpose of enabling those companies to carry out construction programs without having to go to the public for financing, or to enable them to refinance or do original financing at times when the market was propitious.

8633

The advances by the holding company particularly avoided the necessity of going to the market too frequently for money.

As an example of that, in 1920 and 1921, The North American Company and Wisconsin Edison Company advanced cash to the Milwaukee Electric Railway and Light Company, which was the predecessor of the present Wisconsin Electric Power Company, from month to month, which resulted in a total amount owing by that company to The North American Company of \$8,123,000 in May, 1921.

8634

These advances were to enable that company to take care of its construction expenditures, because it could not at that time sell bonds because of a limitation in its mortgage as to the interest rate on the bonds. It could not at that time sell bonds except at an interest rate of 5 per cent. or less, and it could not have financed on that basis.

In 1921, a new mortgage was authorized by the stockholders, and \$5,000,000 of bonds were sold, and the proceeds

—6,974—

were applied in June, 1921, in part payment of the debt to The North American Company, and the remainder of the debt was not paid off until late in 1922.

As another example, in February, 1926, The North American Company advanced \$4,000,000 to the Milwaukee Electric

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8635

Railway and Light Company, to enable that company to redeem at maturity \$6,500,000 principal amount of 5 per cent. consolidated mortgage bonds.

The advance was carried on open account, and was partly paid off in the next few months and finally settled in June, 1926, when the North American Edison Company bought an original issue of \$4,000,000 par value of common stock of the Milwaukee Electric Railway and Light Company, and that company deposited the proceeds with The North American Company.

8636

And as another example, early in January, 1931, The North American Company advanced \$5,670,000 in cash to the Milwaukee Electric Railway and Light Company to enable that company to redeem at maturity \$6,728,000 principal amount of its 4½ per cent. bonds.

This advance is not on the schedule, because it was a short-term advance to enable that company to have the property released from the mortgage so that it could sell a new issue; and the North American's loan to the company was repaid on the 2nd of February, in 1931, from the proceeds of the sale by the Milwaukee Electric Railway and Light Company of \$15,000,000 principal amount of 5 per cent. first

8637

—6,975—

mortgage bonds.

Q. I take it that the entire proceeds were not required for the repayment of the advance, however, is that correct?

A. No; but, incidentally, the company might have had some difficulty at that time in borrowing the full requirement, because it had already borrowed \$3,300,000 from Wisconsin banks for the purpose of meeting part of the maturities at that time, and that loan of course was also paid off.

8638

Herbert C. Freeman—By Respondents—Direct

In 1923, The North American Company advanced cash to Union Electric Company of Illinois to enable that company to construct the Cahokia power plant. Those advances reached a maximum of \$12,232,000, on January 31, 1924, and at that time the Union Electric Company of Illinois sold bonds and preferred stock to the public and sold common stock to The North American Company and reduced the debt, its debt to The North American Company, to about \$3,200,000.

8639

That debt was not entirely paid off until December, 1924, and at that time it was assumed by Union Electric of Missouri.

Then one of the most important examples of this assistance in the form of advances was during the period from June, 1929 to September, 1931. The North American Company made continuous advances to Union Electric of Missouri, which reached a maximum of \$17,180,000 at about the end of that period; in fact, that went over into 1932.

—6,976—

8640

Those advances were to enable the Union Electric Company of Missouri to build the Bagnell dam and the Osage reservoir, and to construct an addition to the Cahokia plant, and to purchase the River Mines plant from the St. Joseph Lead Company.

During that whole period, successive advances were made, which amounted to an aggregate of \$48,000,000, which were liquidated from time to time in various ways.

In December, 1929, the Union Electric Company sold bonds to the extent of \$14,860,000, and in September, 1930; February, 1931; and June, 1931, the amount of the advances

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8641

was reduced by the sale of additional common stock to The North American Company, and that common stock which The North American Company bought and which was applied against the advances amounted in all to \$22,500,000; and then the balance of the loan was paid off gradually over the period up to 1935.

Q. There has been some testimony in the record as to services rendered to the various subsidiaries in connection with financing matters. Would you state very briefly the general scope of the type of service which North American and its personnel has rendered over a period in this type of corporate function? A. Broadly speaking, those services have consisted in discussing the financing requirements of the various companies with the companies, planning the form of financing, deciding whether it should also include the re-

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—6,977—

financing of outstanding securities, the question of not only the timing from the point of view of the market but in later years from the point of view of attempting to do the financing within the period for which the audited statements of the companies were available for registration statements, so as to avoid the expense of interim audits.

8643

Then, in connection with registrations themselves, the North American organization has reviewed and assisted in the preparation of registration statements under the Securities Act, particularly including a review of the financial statements from the point of view of ensuring adequate disclosure and correct statements.

Q. (Interposing) In that connection, Mr. Freeman, what has your own record been in respect to the various regis-

8644

Herbert C. Freeman—By Respondents—Direct

tration statements filed by subsidiaries of North American since the passage of the Securities Act? A. Well, after the passage of the Securities Act, the first real financing was that of the Cleveland Company in 1935, and following that, until a very recent date, when my time has been very much taken up on another matter, I assume I have gone carefully over every registration statement and all of the financial statements of the company.

8645

Q. Did I understand you to say that you assume that you had, or that you actually had? A. Well, I actually have, yes.

—6,978—

Q. And the one financing which you refer to which you did not cover in detail personally was the Cleveland financing in 1940, was it? A. Yes. As to that, I did review some of the statements very briefly, but not in as great detail.

We have also reviewed the mortgage and charter provisions from the point of view of the impact they have on the companies' operations, and we have assisted in the preparation of bank loan agreements.

3646

Q. (Interposing) Now, why is that important? A. Well, that is important from the point of view of the complexity that has developed in those bank loan agreements, particularly with respect to the long term bank loans.

They have assumed almost the proportion of indentures, although they are still in the type of bank loans.

We have been instrumental in introducing into the various indentures and into the charters as they have been revised from time to time, new ideas, over a long period, such as the adoption of the open-end mortgage, the issuance of bonds in series, and issuance of preferred stock in series,

and the various other improvements in order to make these instruments more adapted to the operation of the company from the practical point of view; and we have seen that those provisions have been revised and brought up to date and, as far as possible simplified from the point of view of their

—6,979—

operation, from time to time.

We have sat in with the representatives of the companies, and in some cases we have to a certain extent headed up the negotiation with bankers, and we have discussed with bankers the formation of the syndicates; we have assisted in arriving at prices and underwriting terms; we have generally organized the closing details; we have taken care of the closing matters; we have reviewed the Stock Exchange listing applications from time to time, and have discussed with the representatives of the Stock Exchange the various agreements and in some cases the fees and other terms of listing.

8648

Those services have occupied the time, a considerable part of the time of a number of the members of the organization: Mr. Fogarty, who has been, I would say, primarily responsible for financing; Mr. Piske, Mr. Hartel—

8649

Q. (Interposing) Mr. Hartel is the secretary of The North American Company? A. The secretary of the company.

Mr. Van Wyck, who was associated with the organization in New York for a number of years, and has testified as to his work during that time, and since; I have spent a good deal of time on these matters; and Mr. Preger, the comptroller of the company, has reviewed very carefully all of the financial statements.

—6,980—

8650

Herbert C. Freeman—By Respondents—Direct

Many of these details that I have mentioned have arisen particularly since the passage of the Securities Act and the Stock Exchange Act.

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Prior to the passage of the Securities Act, practically all of the details were handled in New York. At that time, the period of time occupied in the actual closing of the negotiation for financing and the issuance of the securities was generally much less. The consideration of the financing may have extended over a long period, and it may have come up several times, but finally, when the conditions were right, the preparation of the final papers and the agreements with the bankers were frequently concluded in a short time, and in most cases the bankers' circular was prepared on the basis of information which we obtained from the subsidiaries and put in the proper form for inclusion in the president's letter to the bankers and the bankers' circular.

8652

Subsequent to the passage of the Securities Act, that has still been true, except that the amount of detail that has to be done on the registration statement generally involves a considerable amount of work by the subsidiaries in their own offices, before the papers are sent on to us for review, and more recently there have been some cases of financing in which the subsidiary companies have taken a more definite and perhaps more complete part in the arrangements and in the final agreements with the bankers. For example, the

—6,981—

preferred stock financing in 1939 and 1940 of the three Wisconsin companies, that is, Wisconsin Electric Power Company, Wisconsin Gas & Electric Company, and Wisconsin Michigan Power Company, were to a large extent dealt

with locally, and local bankers were largely interested in these financings. In fact, the two small companies were handled entirely by local bankers; and in the case of the large company, there was also an underwriting entirely by local bankers, but predicated upon the acceptance of an exchange offer by a substantial percentage of the holders of the old stock.

Q. Well, in these three instances you refer to, were the basic documents also reviewed by North American? A. Yes, they were.

8654

Q. And advice and assistance given in connection with the consummation of the transaction? A. Yes, to a considerable degree.

Q. Now, you spoke of assistance in connection with execution of bank loan agreements. Can you illustrate the point? A. Well, one of the most important of those bank loan agreements was the Wisconsin Electric Power Company loan, in 1938, the details of which were worked out almost entirely by us in New York, with the banks, and the Union of Illinois and Union of Missouri financing in 1937 and 1938, and in those cases there was one short bank loan for the purpose of enabling the outstanding stock, which was then

8655

~~6,000,000~~
outstanding to the extent of \$13,000,000, to be reacquired by the company, and interims sold for an equivalent amount of new stock.

Q. By "interims" you mean interim receipts? A. Interim receipts.

The new stock could not be delivered until the old stock had been reacquired and its characteristics changed, which

8656

Herbert C. Freeman—By Respondents—Direct

required a unanimous vote of the stockholders, and for that purpose a short term bank loan was secured.

There was also a \$15,000,000 long-term bank loan, which was arranged for in connection with the refinancing of the bonds of the Union Electric of Missouri.

8657

Q. Well now, in addition to the assistance in connection with transactions involving public offering of securities, has North American over a period of many years assisted in the important corporate readjustments and consolidations involving companies in the North American system? A. Yes, it has.

Q. Will you state— A. (Interposing) Many of those have involved a considerable amount of work over extended periods.

I can give some examples of that. In the case of the Light & Development Company of St. Louis, in 1923 to 1924, The North American Company, through a wholly-owned subsidiary, the Edison Securities Company, purchased the entire capital stock of the Light & Development Company of St.

—6,983—

8658

Louis, in March, 1923. That company was a holding company which controlled operating properties in Missouri and other states. It was acquired partly for cash and partly by the issue of stock of The North American Company, which was exchanged for the stock of the Light & Development Company of St. Louis and in part for stock of Union Electric Light & Power Company.

In April, 1923, the Light & Development Company sold four of its operating properties in Missouri to the Union Electric Light & Power Company, and after that the Light

& Development Company disposed of certain properties, which we felt were not related to our then operating subsidiaries, located in Ohio, South Dakota, Illinois, Texas and Kentucky.

Then in August, 1924, the Union Electric Light & Power Company acquired the entire capital stock of the Light & Development Company of St. Louis from Edison Securities Company, and the company was dissolved.

Q. I do not know that we have identified Edison Securities Company. What was it? A. It was a wholly-owned subsidiary of The North American Company, which had no organization of its own. It held securities of various kinds from time to time, and one of its important functions was to provide for the realization of cash for stockholders of The North American Company who wanted cash in lieu of their stock dividends.

8660

—6,984—

Q. And that company was liquidated at or about what time? A. I believe it was about 1934. I am not positive as to that.

Another example is in connection with the unification of the transportation properties here in Washington, which occurred in December, 1933.

8661

At that time the Washington Railway & Electric Company transferred the ownership of its transportation properties to Capital Transit Company, the new company that was organized at that time, in exchange for a 50 per cent. interest in the capital stock of Capital Transit, and other consideration, including the assumption of certain funded indebtedness.

8662

Herbert C. Freeman—By Respondents—Direct

Capital Transit Company, which was organized at that time, also acquired the properties formerly owned by the Capital Traction Company.

8663

Q. I think the details of the transaction may already appear in the record. Would you indicate what part North American played in connection with the transaction? A. Well, the preliminary steps which led up to that extended over quite a long period, and during that time the officers of The North American Company were in constant discussion of the matter with the management of the Washington Company.

—6,985—

It involved an agreement as between the Capital Traction Company and Washington Railway & Electric Company, as to the general basis upon which they would be willing to bring about the unification, and it then involved the securing of a resolution of Congress to permit of the carrying through of the transaction; and thereafter it included the actual working out of the details of the contract and the consideration to be received by the two companies.

8664

It took a great deal of time of all of our executives, more particularly of Mr. Doolittle, who was at that time a vice president of The North American Company; and later I spent a good deal of time on the matter, too.

Then following the unification of the transportation properties in 1933, the Capital Transit Company acquired the capital stock of the Washington Rapid Transit Company, and there again the officers of The North American Company spent a considerable amount of time on the negotiations.

I, myself, did a great deal of work in connection with that.

Herbert C. Freeman—By Respondents—Direct

8665

Then coming to 1937, in connection with the reorganization of the Illinois subsidiaries of Union Electric Company of Missouri, under which four of those subsidiaries were merged into a fifth subsidiary, which then changed its name to Union Electric Company of Illinois, the present company, all of the outstanding indebtedness and the preferred stocks

—6,986—

of these companies were retired, and the resulting Union Electric Company of Illinois was refinanced by the issuance of \$18,000,000 of its common stock and \$22,000,000 of first mortgage bonds to the Union Electric Company of Missouri, and those securities formed a part of the basis for the bond issue of Union of Missouri in that year.

8666

Q. Well now, in this transaction, did North American again take an active part? A. I should say we took a major part in those discussions.

The Examiner: We will suspend here for just a moment.

(Whereupon, a short recess was taken.)

By Mr. Hamilton:

8667

Q. And in the actual consummation of the transaction?

A. Yes, although, of course, the final carrying of it out as to the unification of those Illinois subsidiaries was attended to in St. Louis.

Then in 1938, in connection with the refinancing of the Milwaukee Electric Railway & Light Company, which at that time became the Wisconsin Electric Power Company, that company, the Milwaukee Electric Railway & Light Company, acquired from The North American Company all of

8668

Herbert C. Freeman—By Respondents—Direct

the common stock of the old Wisconsin Electric Power Company, which had been organized to construct the Lakeside plant.

At that time, the Milwaukee Electric Railway & Light
—6,987—

Company transferred its transportation properties and business to a new wholly-owned subsidiary, which it formed, called the Milwaukee Electric Railway & Transport Company.

8669

Q. Here, again, I think the actual detail of the transaction is probably in the record, and I would like to get at the function of North American in the consummation of the transaction. A. Well, that transaction was discussed several times. I have one particular personal recollection of it, because I was away on a vacation and I had to come back to New York for a day to sit in on a discussion of it with the officers of the company, who came to New York, and the working out of the final details consumed a considerable amount of time on the part of Mr. Fogarty, Mr. Piske and myself, in conjunction with the officers of the company.

8670

Q. What was the purpose of that transfer of stock by North American to the then Milwaukee Electric Railway and Light Company? A. It was to improve the financial position and credit of the Milwaukee Electric Railway and Light Company.

Up to that time, the Lakeside plant had been operated by the Milwaukee Electric Railway and Light Company under a lease, and that lease rental, while it was limited to a certain percentage of the return on property of Wisconsin Electric Power Company, actually came ahead of the bond

interest on the bonds of the Milwaukee Electric Railway and Light Company. —6,988—

By permitting them to acquire that stock and liquidate the old Wisconsin Electric Power Company, and acquire its property direct, it not only gave them a larger property base on which to issue their new bonds but it removed that prior charge.

Q. Well, did it not, in fact, permit the refinancing of Milwaukee Electric Railway at that time? A. It was the one thing which made that financing possible at that time. 8672

Q. Had not other attempts been made prior to that time to attempt the financing of Milwaukee Electric Railway without the acquisition of the old Wisconsin Electric Power Company? A. There had been various discussions, but—

Q. (Interposing) Had they been successfully worked out? A. No, no plan had been developed which seemed at all practicable. Of course, there are a great many other examples of assistance of that character, but I think those are fairly representative.

Q. Now, has The North American Company, and has it for many years, given its subsidiaries assistance in connection with the establishment of accounting procedures? A. Yes, it has. 8673

—6,989—

Mr. Preger, our comptroller, has always kept closely in touch with the subsidiary companies, and has passed on to them the benefit of his study of the various accounting classifications and matters of that kind, and results of his discussion with the auditors of the company.

He and I have discussed accounting matters a great deal, and he and I, together, have had numerous discussions with

8674

Herbert C. Freeman—By Respondents—Direct

the accounting officers of the various companies on different matters, both personally and by correspondence.

He keeps in touch with the requirements of the various regulatory commissions and the Stock Exchange and matters of that kind, and passes on the results of his experience and study to the subsidiaries.

As far as possible, of course, we try to bring about uniformity, but obviously a subsidiary is subject to the requirements of its own regulatory commission.

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(Pause for the shifting of reporter.)

—6,990—

The Witness: In that connection, I should like to emphasize that our policy has consistently been that of requiring full disclosures with respect to our own accounts, and of advising the subsidiary companies along those same lines. We have tried to see, in our review of their finances, that that policy is carried out.

8676

In recent years, the development of the notes that have been attached to financial statements has been quite a marked feature of disclosure, and we have gone over those and discussed them at considerable length, in many cases, with subsidiaries.

I think I mentioned yesterday that it was in furtherance of our policy that the subsidiaries introduced auditor's certificates into their annual reports.

By Mr. Hamilton:

Q. How about inclusion of surplus accounts in the financial statements? A. I was going to speak of that. There had

been a practice for a great many years among,—I was going to say among companies, generally, of publishing income statements and balance sheets, but not necessarily of surplus accounts. However, we felt that the inclusion of a surplus account was a necessary part of the presentation of accounts to stockholders, and in the case of our own company, that was reflected in the annual report, I think, as early as 1923, and we have recommended to the subsidiaries that they include

—6,991—

it in their annual reports, and that has been done for a number of years.

8678

Q. Is assistance also given in connection with monthly reports, in connection with the preparation of budgets? A. The assistance in connection with the monthly reports has been largely to the extent of the detail that should be given in the reports and the form of them. The subsidiary companies are making monthly reports which not only give a comparison with the same month of the previous year, but also with the budget, and we have assisted them, to a considerable extent, first, in the preparation of the budget and the manner in which the budget should be prepared, and also in the form of presentation of the results in comparison with the budget.

8679

Officers of the North American Company have visited the various subsidiaries and discussed their budgets with them before they were adopted, and made various suggestions.

I was speaking, principally, of the operating budget.

There are also the construction budgets, which, of course, have to be looked at from the point of view not only of a formal presentation, but as to what expenditures are to be

8680

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authorized, and what can be deferred, what additions—which ones are required to be made to meet the conditions as they arrive, and so on, and the officers of the North American Company have at all times kept in close touch with the subsidiaries on the matter of construction budgets.

—6,992—

8681

We have also had officers in New York who were Engineers and who could discuss those matters in the terms of engineering language with the officers of the operating subsidiaries.

8682

Q. Is there an Auditor with the North American Company, and, if so, what does he do? A. The Comptroller is, of course, to some extent, the Auditor, too, of The North American Company as such; but, in addition to that, we have a man who is known as Auditor, whose business it is to organize the internal audit systems of the subsidiary companies where organizations are necessary. Perhaps it is too much to say, organizations; they have all had internal auditing departments, but we felt that there was room for improvement, possibly, in the work they were doing, particularly in the uniformity of the work as among the various companies, and the auditor has made a study of their methods and of the scope of work being done, and has advised with them and visited the offices of all of the operating companies. We believe that the internal audits have been definitely improved and standardized as a result of his work.

There have been meetings of the accounting officers of the various companies to discuss these things as a group; to exchange ideas and to assist one another in formulating the plans and defining the scope of the auditing work, and the

Auditor of the North American Company has attended those
—6,993—
meetings.

Q. Does North American Company assist in the preparation of Original Cost studies by the subsidiaries where required? A. Yes; our assistance there has been chiefly in the nature of a review of the reports prepared by the Research Department and Accounting Departments of the various companies. Those reports have involved a tremendous amount of work by accountants and engineers and that work has necessarily had to be done originally by the force of men employed by those companies; but when the classifications have become available, we have discussed that with them, and I know that Mr. Preger and I have sat down and gone over them, and the Accounting Department has advised them as to the treatment of different items, and Mr. Doolittle has also participated in that work in connection with the companies here in Washington, of which he is still a Director.

8684

Q. Now, is assistance also given in such matters as depreciation studies? A. Yes. That has been one of the divisions of the accounting work in which Mr. Preger and I, particularly, and the present officers of the company, have

8685

—6,994—
participated. Mr. Doolittle also used to participate in those discussions, and there the work has been along the lines of studying the subject from time to time and discussing it with local commissions and trying, as far as the subject will permit, to reach some degree of uniformity of treatment.

Q. Now, as to matters regarding compliance by the subsidiaries with regulatory statutes, is assistance also given by North American in this respect? A. Yes. In that re-

8686

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spect, Mr. Piske and Mr. Hartel have been the officers of North American Company who have devoted the most time to that; that is, the studies of the various laws and regulations issued under those laws,—the requirements of the Federal Power Commission, the Securities and Exchange Commission, and the other regulatory bodies.

8687

This included a study of the Securities Act of 1933 and the regulations under it; the Securities and Exchange Act of 1934, and the Holding Company Act of 1935, and, of course, it extends not only to registrations, but to such matters as proxy solicitations, and matters of that kind.

The financial connections of Directors are studies, and all the procedure necessary in connection with the acquisition and sale of securities and property and the elimination of subsidiaries and various reports that have to be made, are advised upon. —6,995—

8688

Q. Is assistance similarly given in connection with the review of applications to State Commissions for authority to issue securities? A. Yes. Wherever there is a matter of financing, which, of course, necessarily requires an application of that kind, copies are sent to us in New York, and they are reviewed, by several of us in fact, and Mr. Piske and Mr. Hartel particularly, and I also make a practice of reviewing those, but not in as great detail as they do.

Q. Now, I think you referred to services rendered in connection with compliance with the Securities and Exchange Act of 1934. What does that involve? A. Originally, there was the preparation of Form 10, Application for Registration; and following that, the Annual Report Form, which is Form 10-K; the monthly reports on Form 8-K, where there

have been changes in control,—and Annual Reports on Form 1-MD for companies issuing securities registered under the Securities Act, but not under the Exchange Act.

Q. Are their applications in various forms, reviewed by North American? A. Yes, initially it required a great deal of attention, but it has now become more standardized, from year to year, and we are able to review them with the expenditure of less time,—but they are all reviewed.

—6,996—

Q. In all these matters, has it been the experience of North American that the subsidiaries rely heavily on North American for this type of assistance? A. Yes, that is a correct statement. 8690

Q. As to certain fiscal matters, has assistance similarly been furnished to subsidiaries, and if so, in what respects? A. Particularly in connection with those subsidiaries which have securities listed on the various stock exchanges, and of course all our major subsidiaries have listed securities.

We review the listing application, the printing of those things I think is required to be done in New York, and we negotiate for that with the printers and attend to it. There is a certain amount of negotiation required with the various exchanges as to the fee payable. 8691

Q. Does listing on the New York Stock Exchange require agreement on the part of the applicant company with the Exchange? A. Yes. They are quite comprehensive agreements.

Q. Those agreements have been entered into, have they, in the case of North American subsidiaries so listed? A. Yes.

Q. Is assistance given to the subsidiaries in connection with compliance with these agreements? A. Yes. We keep

8692

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in touch with the subsidiaries as to the filing of the reports called for by those agreements, notices of corporate action

—6,997—

on various matters and so on. Mr. Piske and Mr. Hartel have been the officers who have been chiefly attending to those matters.

Q. Again in this respect has it been your experience that the subsidiaries rely heavily on North American for this type of service? A. That is so.

8693

Q. Are there other corporate matters in which North American renders assistance to subsidiaries? A. On a great many matters which might be described as of a secretarial character, Mr. Piske and Mr. Hartel, and some of the other officers of the company, review their proxies, their notices of stockholders meetings, and they have assisted them at various times in working out forms of presentation of their agenda for their meetings,—their minutes their procedure for annual meetings, and various matters of a secretarial character.

8694

These things of course, cannot be entirely uniform, but we do try to give each subsidiary the benefit of the experience of the other companies, and of ourself.

Q. Now, in connection with the operating matters, what assistance is given by North American to the subsidiaries? A. May I revert to one matter in connection with that last question? That is, in connection with the modernization of By-Laws. There, again, uniformity is not entirely prac-

—6,998—

ticable, but as far as is possible, we try to see that the By-Laws are those best adapted to the operation of the com-

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8695

pany, and we have helped them to modernize their By-Laws, from time to time.

Will you repeat the question, please?

(Whereupon the pending question was read by the reporter.)

The Witness: The North American Company has also had certain officers who have been engineers, and who could discuss with the executives of the operating companies matters of an engineering character, construction budgets, matters of that kind, or major projects involving engineering questions,—and so forth. At times, I think some of those projects have been perhaps initiated by the New York officers, but at any rate, they are discussed.

8696

Then, in connection with the relation of the subsidiaries with the local Commissions, the officers of the North American Company have been of assistance in discussing those matters, from the point of view of broad policy.

The rate policies of the subsidiaries have been discussed constantly by the officers of the North American Company with the subsidiaries.

8697

Q. With what end in view? A. To carry on our policy of the lowest rate consistent with the general situation. I can refer to these things in connection with the personnel who have been chiefly responsible for them.

—6,999—

Mr. Dame, for example, who was the President of the North American Company from 1921 until 1933,—he was

8698

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President at the time of his death, but had, for a short time been Chairman of the Board of Directors while Mr. Gruhl was President. Mr. Dame was an engineer and an operating man, so that he was particularly qualified to discuss all these major projects, and relations with Commissions, and so on, with the officers of the subsidiaries. Mr. Gruhl, who became Assistant to the President of the company in 1912, and later, Vice-President and General Manager, and was President at the time of his death in January, 1933, was originally a Commission man in Wisconsin.

8699

Q. Do you mean by that associated with the Commission?

A. On the staff of the Commission in Wisconsin. He was of very great assistance to the officers of the subsidiaries, in connection with commission regulations and general operating matters. He and Mr. Dame worked very closely, when they were both alive, and practically all of the major projects of the subsidiaries were discussed by the executives with them, that is, by the executives of the subsidiaries.

8700

Of course, during that time Mr. Fogarty was the officer who was primarily interested in matters of financing; Mr. Doolittle, who is also an engineer, was an officer of the company from 1923 to 1936.

Q. He is now a director of the North American Company?

—7,000—

A. He is now a director of the North American Company, and also of the Washington companies, Washington Railway & Electric Company, and Potomac Electric Power Company and Capital Transit Company, and he has remained in very close touch with us since 1936, and has assisted on various matters since that time. He paid particular attention to

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8701

construction budgets and to a number of these matters of corporate reorganization which I have mentioned, particularly those having to do with these Washington properties, and with the St. Louis properties.

Mr. R. G. Smith was on the staff of the North American Company from 1921 to 1935 and I think he was, for several years, Assistant Vice-President of the company. He had had experience with the Wisconsin Commission and was also an engineer. He was the head of our statistical department, and kept in close touch with the various operating reports of the subsidiary companies, and generally assisted Mr. Doolittle in his work with the subsidiaries.

8702

Mr. J. B. Black, who is now President of the Pacific Gas & Electric Company, is also an engineer and an operating man. He had been in charge of the operations of the Great Western Power Company, which was a subsidiary of Western Power Corporation, and was President of that company at that time,—excuse me, I am not sure he was President, but he was the chief operating officer of that company at the time we acquired Western Power Corporation, and in 1926 he became Vice-President of the North American Com-

8703

—7,001—

pany.

Q. And acted in that capacity until what date? A. Until 1935, at the end of 1935. Then Mr. J. D. Mortimer was an engineer and an operating man, and his connection with the North American Company goes back longer than any of the others. He first became associated with the company in 1909 and was President of the Company up to the time of his retirement in 1920, and then he became associated with the company again in 1933 and continued up to 1938.

8704

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In those early years, of course, we only had the St. Louis and the Wisconsin companies and he spent a great deal of time actually on the properties. In fact, I believe part of the time he was President of the subsidiary companies, as well as of the North American Company.

More recently, from 1933 to 1938, he was the man to whom we looked for the chief contact with the subsidiaries on operating matters, and he discussed matters of construction budgets and major projects with them.

8705

Then, in 1940, Mr. Ralph Moody, who had been with the Wisconsin group of companies for a great many years, was brought on to New York, and first became Assistant to the President, and later, Vice-President of the company. He is an engineer and an operating man, and can talk to the operating officials of the companies in their own language, and

—7,002—

understands their problems thoroughly.

8706

Mr. Lindseth, who has testified in this proceeding, was associated with the Cleveland Electric Illuminating Company for a few years as,—I believe he was called Assistant to the President.

Q. I think his title appeared in the record. Does he assist Mr. Moody? A. In September, 1940, we asked the Cleveland company to release him to us so that he might become assistant to Mr. Moody.

Q. Are the North American Company and its subsidiary holding companies subject to the Uniform Classification of Accounts for holding companies provided by the Securities and Exchange Commission? A. They are.

Q. And do they conform to such classifications of accounts? A. Yes, they do in all respects.

Q. In its entire history, has the North American Company had a service company providing management, construction or other services for compensation? A. No. We have not had a service company of any kind. There was a short period, from the latter part of 1924 to 1928, when we held the stock of an engineering company which performed services for outsiders, and was engaged by one or two of the

—7,003—

subsidiaries of the North American Company to do work for them, but we disposed of that stock in 1928.

Q. Was the issuing of the presently outstanding 5¾% Preferred Stock and presently outstanding Debentures of the North American Company authorized by the Securities and Exchange Commission under the Holding Company Act of 1935? A. The issuance of those securities was authorized in January, 1939, by the Securities and Exchange Commission.

Q. Are you able to state the range of earnings, on a corporate basis, per share, of North American Company over a period of years? A. For the period from 1923 to date, the earnings per share of North American Common Stock on a corporate basis have been from 93 cents a share to \$2.86 per share.

Q. In each case have consolidated earnings been in excess of corporate earnings? A. Yes.

Q. During that entire period? A. Yes.

Q. During this period, have dividends ever been paid on North American stocks in excess of corporate earnings for the particular years? A. No, they have not been; during that

8710

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period of years we were paying stock dividends I am and including those on the basis on which they were capitalized, —that is, during part of that period, I should say.

—7,004—

8711

Q. Are you able to state the coverage for 1940 on the outstanding Debentures and Preferred Stocks, of North American Company on a corporate basis? A. The coverage in 1940, and by that I mean the number of times the Debenture interest was earned, was seven times, and the Preferred Stock dividends were earned more than four and one-half times.

Q. After providing for Debenture interest? A. Yes.

Q. Have all contracts within the holding company system involving the sale of stock by North American or North American Edison to any public utility company in the system been approved by the respective State Commission to which the particular public utility companies were subject. A. They have.

8712

Q. Has the North American Company ever received payment from the public utility subsidiaries for construction work or for equipment or materials? A. No, it has not.

Q. Has it received payment for services rendered? A. For a period of years, there was an apportionment of the cost of the North American organization under which, on the basis of tests made from time to time, the proportion of the time spent by the various departments on North American

—7,005—

matters purely was applied to the total salary cost of the departments, and the balance representing the time spent by those departments on the affairs of the subsidiaries was

in the aggregate, apportioned among the subsidiaries roughly in proportion to their gross revenues.

Q. Now, when was this arrangement discontinued, if it has been? A. It was discontinued in November, 1935.

In case I have not been sufficiently explicit, I will say that a part of that apportionment represented a part of the salaries of the officers of the North American Company, but as to that, it represented a smaller proportion of their salaries than it did of the salaries of the rest of the organization.

8714

Q. Did the services rendered under the arrangement include such matters as stock transfer and fiscal agency service? A. As to that, there were specific charges made for services as fiscal agent, based, as nearly as could be, on the fees charged by trust companies in New York for similar services, and based upon the volume of securities to which the various work related.

Those charges were not in excess of what the cost would have been if done for the subsidiaries by a trust company.

Q. If you happen to know, does the requirement of the

—7,006—

8715

New York Stock Exchange with respect to listing of stocks thereon include a requirement that there be a New York transfer agent? A. There must be a transfer agent located south of some particular street in New York,—I have forgotten which one it is.

Q. To your knowledge, has the North American Company ever prevented a rate reduction by any of its subsidiaries?

A. No.

Q. Has it ever attempted, to your knowledge, to force an increase in rates by any of its subsidiaries? A. No, not to

8716

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my knowledge. I do not believe there ever have been increases in rates, except during the period of the last great war, when some adjustments upwards were made by the various subsidiaries.

8717

Q. Have you any statistics to indicate the relative relationship between the dividends paid by the public utility subsidiaries of the North American Company, over a period of years, to the earnings available for dividends of those companies during those years? A. There has been prepared, under my direction, figures showing the percentage which the dividends paid have represented of the amount available for dividends during the period of fifteen years from 1925 to 1939 for the four groups of companies which constituted the subsidiaries of the North American Company during that

—7,007—

period.

Q. These groups being what? A. Wisconsin-Michigan group, Missouri-Illinois-Iowa group, the Ohio group and the Washington, D. C. group.

8718

Q. By the "Missouri-Illinois-Iowa group", are you referring to Union Electric Company and subsidiaries? A. And the St. Louis County Gas Company. A. And what do those statistics disclose? A. They show that during the fifteen-year period from 1925 to 1939, the Wisconsin-Michigan group paid, as dividends on Common Stock, 76.17 per cent. of the earnings available for dividends; that the Missouri-Illinois-Iowa companies paid 76.09 per cent. of the earnings available; that the Cleveland Electric Illuminating Company paid 65.78 per cent., and the Washington companies paid 58.17 per cent. The average for these four groups is 69.05 per cent.

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8719

Q. Is that an arithmetical average? A. That is an arithmetical.

Q. Have you data on the same subject matter with respect to the record of other public utility companies not subsidiaries of the North American Company? A. I have had data prepared from the manuals for eight independent companies.

Q. What manuals do you refer to? A. Poor's Manuals of Utilities. The eight companies are the Hartford Electric

—7,008—

8720

Light Company—

Mr. Binford: (Interposing) Mr. Examiner, I object to any statement as to dividend policies of utility companies not involved in this proceeding as being wholly irrelevant and immaterial.

We have no evidence of their performance and a full investigation of the conditions existing with respect to such companies, I think would prolong a hearing of this sort indefinitely, and beyond the physical possibility of completion.

The Examiner: Doesn't this objection go to the same point you raised against the four sheets embraced in Respondents' Exhibit No. 124?

Mr. Binford: Yes, it does.

Mr. Hamilton: May I make a few remarks on that?

The Examiner: You may.

Mr. Hamilton: I believe the evidence is entirely relevant for a number of reasons: For one reason, it shows a contrast in dividend policies between companies which are generally acknowledged to be so-

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Colloquy

called leading independents and the dividend policies in this particular holding company system. It therefore is relevant as showing the conservative nature with which the enterprise constituting the North American system has been conducted. It is relevant as showing, by inference, at least, that the North American Company has not adversely, as a holding company, obstructed the dividend policies of its sub-

—7,009—

8723

sidiaries. The information is stated to be over a period of fifteen years, and to be based in the case of the so-called independents, on published financial statements and is therefore the best evidence, under the circumstances, from which any inference as to the conduct of the North American business, favorable or otherwise, may be arrived.

The Examiner: I don't understand that he is objecting to the source.

Mr. Hamilton: That is right. It bears again on the relevancy as providing a basis of comparison and the fairness of comparison.

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Mr. Binford: Mr. Examiner, in accepting this type of testimony, we would, in effect, be recognizing these companies selected by the respondent, I suppose with considerable care, as standards by which to judge the fairness and policy of North American and its efficiency, and I believe that could not be done without a great deal of evidence as to these companies and the peculiarities of their individual situations which might affect their efficiency or their rates.

Colloquy

8725

I insist on the objection.

Mr. Hamilton: May I also point out that, in general, that type of comparison has been used by the Federal Power Commission, I don't say necessarily with respect to dividend matters, but certainly with respect to operating policies and costs, where the report of one company might be compared with the

—7,010—

reports of a number of certain other holding companies.

8726

Mr. Binford: I think that the principle is right, generally speaking, but this happens to be a proceeding with relation to a particular system.

Mr. Hamilton: If I am correct, the Commission, itself, has used a somewhat similar basis of comparison in not dissimilar cases.

The Examiner: Off the record.

— (Discussion off the record.)

—The Examiner: I suggest that you proceed with your line of examination, and then, if Mr. Binford desires, he can move to strike, and I will dispose of the question later on, both as to the admissibility of this testimony and the four sheets from Respondents' Exhibit No. 124.

8727

Mr. Binford: I have no objection to that procedure, understanding from counsel that this will not be an extended line of testimony consuming a great deal of time, and that, as the Examiner stated, I shall have a right to move to strike the testimony at the conclusion thereof.

8728

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The Examiner: All right. I understand the testimony will take about five minutes, so you may proceed.

Mr. Hamilton: Will the reporter read the pending question?

(Whereupon, the pending question was read by the reporter.)

—7,011—

8729

The Witness: Hartford Electric Light Company, Commonwealth Edison Company, The Detroit Edison Company, Public Service of Northern Illinois, Boston Edison Company, Consolidated Gas, Electric Light & Power Company of Baltimore, Pacific Gas & Electric Company, and Southern California Edison Company.

By Mr. Hamilton:

8730

Q. Now, what do these data disclose? A. These data disclose that for that group of eight companies, the average for the entire group of the percentage of dividends paid on Common Stock of the earnings available for dividends during the fifteen-year period from 1925 to 1939 was 77.73 per cent., as compared with the 69.05 per cent. for the four North American groups.

It also shows that the average for the North American groups is lower than seven out of the eight independent companies and higher than only one, the Public Service of Northern Illinois, and that each of the four groups of the North American subsidiaries shows a lower percentage than the average for the eight independent companies.

Q. Now, I notice that you have included in your group of eight companies, Detroit Edison and Pacific Gas & Elec-

tric Company. If those companies were excluded from the computation, what would be the effect upon the averages given? A. The effect would be to increase the percentage of
—7,012—

dividends shown by the average for the remaining six independent companies.

In other words, the percentage for the Detroit Edison Company and for the Pacific Gas & Electric Company is lower than the average of the percentage for the entire eight companies, so that the comparison would be more in favor of the North American groups.

8732

Q. Do the depreciation policies pursued during this period have a bearing on the amount of earnings shown to be available for dividends? A. The amounts of depreciation taken necessarily had a bearing on the amount available for dividends.

Q. Can you state the relative figures on depreciation with respect to the two distinct groups which you have referred to during the period?

Mr. Binford: Mr. Examiner, it is understood, I presume, that the same objection applies to all questions and answers along this line of interrogation,—that is to say, other companies not included in this proceeding, and questions as to their policies.

8733

Mr. Hamilton: I think that is understood.

Mr. Binford: And I will make the same objection and move to strike.

The Examiner: I think that is understood.

The Witness: With respect to depreciation, the percentage of gross earnings of the four North Amer-

—7,013—

8734

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ican groups on a consolidated basis for the fifteen-year period from 1925 to 1939, inclusive, is 11.76 per cent. of the gross earnings; the average for the eight independent companies for that same period is 10.55 per cent. For the year 1939, alone, the percentage for the North American group, on a consolidated basis, is 12.57 per cent. of gross revenue, and—the average percentage for the independent companies, is 11.86 per cent. of the gross revenue.

8735

Q. Now, again, if you will, if Detroit Edison and Pacific Gas & Electric Company were excluded from the so-called independent groups, in arriving at your depreciation, what effect would that exclusion have on the figure you have already mentioned? A. The effect, both as to the fifteen-year period, and as to the year 1939 would be to improve the comparison from the point of view of the North American group of subsidiaries. The percentage charged by both Detroit Edison and by Pacific Gas & Electric Company is higher than the average for the group of eight independent companies.

8736

Mr. Binford: Mr. Examiner, I understand that that concludes that particular line of questioning to which objection has been made, and I therefore move, at this time, to strike all questions and answers, since my last objection, in so far as the same relate to the data concerning companies not a party to this proceeding, upon the same grounds as those stated before in the objection.

—7,014—

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8737

The Examiner: Very well, I will reserve ruling on this motion and will dispose of it at the time I dispose of your objections to the admissibility of the four sheets embraced in Respondents' Exhibit No. 124.

Mr. Hamilton: Please mark this series of tables consisting of four sheets for identification as Respondents' Exhibit No. 127.

(The document referred to was marked for identification as Respondents' Exhibit No. 127.)

8738

By Mr. Hamilton:

Q. Please state what this exhibit represents, Mr. Freeman. A. This exhibit represents a statement of the capital structure of the utility operating subsidiaries, and of North American Light & Power Company and Washington Railway & Electric Company, intermediate holding companies, as of December 31, 1940, showing the respective amounts of capital of each class and of surplus, the percentage which each bears to the total capital and surplus, and the part or stated value of each class of capitalization owned by the North American Company, and the percentage which that ownership represents of the total capital of each of the operating subsidiaries.

8739

Q. Has this exhibit been prepared under your direction,
—7,015—

and have the facts shown therein been taken from the books and records of the company? A. That is correct.

Mr. Hamilton: I offered this exhibit in evidence as Respondents' Exhibit No. 127.

Mr. Binford: I would like to ask a question or two, if I may.

8740

Colloquy

Mr. Freeman, this exhibit covers only utility operating subsidiaries?

The Witness: Except that it does include North American Light & Power Company and Washington Railway & Electric Company, which are intermediate holding companies.

8741

Mr. Binford: It also appears to include the Milwaukee Electric Railway & Transport Company, which is not a public utility within the meaning of the Public Utility Holding Company Act?

The Witness: That is correct. We treat it as a utility, since it is in the street railway business. As to Washington Railway & Electric Company, the percentages of that company's ownership in the securities of its subsidiary companies are shown, and as to North American Light & Power Company, the percentages of that company's ownership in the securities of its operating subsidiaries, and Illinois Traction Company's investment in its operating subsidiaries are also shown.

8742

Mr. Binford: I have no objection.

—7,016—

The Examiner: Very well, the table is received as Respondents' Exhibit No. 127.

(Respondents' Exhibit No. 127 was received in evidence.)

Mr. Hamilton: Please mark this as Respondents' Exhibit No. 128, for identification.

(The document referred to was marked for identification as Respondents' Exhibit No. 128.)

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8743

By Mr. Hamilton:

Q. Please state what this table represents, Mr. Freeman?

A. The table represents an analysis of the consolidated balance for common dividends and surplus by operating subsidiary companies for the ten-year period from 1930 to 1939, inclusive, showing annual deviations from the ten-year average figures. The table is brought down to the balance for common dividends and surplus, but it shows, at intermediate totals, the consolidated earnings available for interest charges and dividends of the North American Company and North American Edison Company, and also the consolidated and the corporate balances available on other bases,—that is, for interest charges and dividends and also for common dividends and surplus.

8744

Q. Has this exhibit similarly been prepared under your direction, and have the facts shown therein been taken from the records of the company? A. They have.

Mr. Hamilton: I offer the exhibit in evidence as
—7,016a—

Respondents' Exhibit No. 128.

8745

Mr. Binford: No objection.

The Examiner: It is admitted under the number mentioned.

(Respondents' Exhibit No. 128 was received in evidence.)

Mr. Hamilton: Please mark this graph, for identification, as Respondents' Exhibit No. 129.

(The document referred to was marked for identification as Respondents' Exhibit No. 129.)

8746

*Herbert C. Freeman—By Respondents—Direct**By Mr. Hamilton:*

Q. Mr. Freeman, does this graph, Respondents' Exhibit No. 129 for identification, express in graphic form the information set forth in the table, Respondents' Exhibit No. 128?

8747

A. It does, as to the items that are described in that table as "Balance for Common Dividends and Surplus of Subsidiary Companies"; and also as to the items in this table described as "Total Consolidated Earnings Available for Interest Charges and Dividends of the North American Company and North American Edison Company".

Q. I note a line appearing somewhat below the center of the graph marked "O".

What is the relative relationship of that line to the other lines shown on the graph? A. The lines on the graph are plotted in such a way as to show the percentage deviation from the ten-year average in each of the ten years indicated

—7,017—

8748

on the graph, and the "O" line marks the division between the point of excess over the average and of deficiency under the average.

Q. In each case, then, it represents the ten-year average to which all other lines are related? A. That is true.

Mr. Hamilton: I offer the graph in evidence as Respondents' Exhibit No. 129.

Mr. Binford: No objection.

The Examiner: All right, it is so admitted.

(Respondents' Exhibit No. 129 received in evidence.)

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8749

By Mr. Hamilton:

Q. Will you state the significance of Exhibits 128 and 129? A. The exhibits show that the fluctuation in the income available for the security holders of North American Company over this ten-year period has been less than the fluctuation in the balances available for the Common Stock of the companies in the North American system, taken in the aggregate; by that I mean that the arithmetical average of the variations in the balance available for common dividends and surplus of the subsidiaries has shown wider variations than the variations in the balance available for security holders of the North American Companies and North American Edison on a consolidated basis; and, that the variations in the individual companies have been greater than the

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—7,018—

variations in the balances available for security holders of the North American Company and of North American Edison Company, in a majority of the years covered in the graph and in the estimate.

Expressing that in figures, the statement shows that the arithmetical average of the deviations of the seven subsidiary companies for the ten-year period has been 26.02 per cent.; while the average deviations in the consolidated balance available for interest and dividends of the North American Company and North American Edison Company combined, has been only 16.54 per cent., and that the number of companies which show a wider variation than the average shown by the balance available for interest and dividend of North American and North American Edison Company is 4 and the number showing a smaller deviation is 3.

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8752

Herbert C. Freeman—By Respondents—Direct

Now, as to the maximum variations during the period, in excess of the average, the arithmetical average for the seven companies is 58.88 per cent., while the maximum deviations in excess of the average is only 46.50 per cent. in the case of the consolidated balance available for dividend and interest of North American and North American Edison Company combined.

8753

As to the deviations below the average, I am speaking now of maximum deviation, the arithmetical average for the seven companies is 42.62 per cent., which compares with only 26.35 per cent. in the case of the consolidated balance available for interest and dividends of the North American

—7,019—

Company and North American Edison Company combined.

The number of companies which show a wider deviation than the North American and North American Edison Company combined, on the high side is only three, as against four which show a smaller deviation on the high side.

8754

Now, on the other hand, the number of companies which show a wider deviation on the low side is five as against only two companies which show a smaller deviation on the low side, as compared with the deviation shown by the North American Company and North American Edison Company combined.

Q. In order to clarify the basis of the consolidation, during what period is, or has been Washington Railway & Electric Company, and subsidiaries, consolidated in the account of North American Company. A. Washington Railway & Electric Company was excluded from the consolidation in the accounts for the year 1939, but for the purpose of this table

it has been included. The reason for its exclusion was that in 1939 our percentage of voting control dropped below, slightly below, 50 per cent., but nevertheless we still held substantially more than 75 per cent. of the common stock at that time.

Q. Now, as to North American Light & Power Company, was it included in the consolidation during the period? A. No, we have excluded North American Light & Power from
—7,020—

this figure for 1939, as that is the only year during this period in which it was consolidated, as, up to that time, we had not had more than 75 per cent. of the common stock. 8756

Q. Actually, it is excluded for the entire period of ten years? A. That is true.

(Discussion off the record.)

By Mr. Hamilton:

Q. Mr. Freeman, have certain companies named as parties in this proceeding been dissolved, or otherwise disposed of, prior to the commencement of the proceeding? A. Prior to or subsequent to? 8757

Q. Prior and subsequent to the commencement of the proceeding. A. There are eleven such companies.

Q. Now, has Washington & Glen Echo Railroad Company been dissolved, and if so, at what date? A. That company was dissolved on February 23, 1939.

Q. Has St. Louis & East St. Louis Electric Railway Company been dissolved, and if so, at what time? A. It was dissolved in July, 1939.

8758

Herbert C. Freeman—By Respondents—Direct

Q. And similarly, have St. Charles Electric Light & Power Company, Lakeside Light and Power Company, and Chicago & Illinois Valley Railroad Company been dissolved?

A. Those three companies were dissolved, the first two in
—7,021—

November, 1940, and the third in April, 1941.

Q. Mr. Van Wyck, I believe, has previously testified as to the dissolution of four subsidiaries of Illinois-Iowa Power Company, so I won't ask you questions with respect to those companies.

8759

Have Wired Radio, Inc., and Wired Rediffusion Developments, Ltd., ceased to be subsidiaries of North American Company, and if so, under what circumstances? A. Those companies ceased to be subsidiaries of the North American Company on April 1, 1940, when the stocks of Wired Radio, Inc. were delivered to Associated Music Publishers, Inc., which, at that time, was not a subsidiary of the North American Company—

Q. And is not now? A. And is not now a subsidiary—in accordance with the contract to deliver the stock.

8760

Q. At that time, North American parted with its ownership, did it, of the stock of Wired Radio, Inc.? A. Of Wired Radio, Inc., and Wired Radio owned the stock of Wired Rediffusion Developments, Ltd.

Q. Has Wisconsin General Railway ceased to be a subsidiary in the North American Company since the institution of these proceedings, and if so, at what date and under what circumstances.

The Witness: Off the record, please.

—7,022—

(Discussion off the record.)

Herbert C. Freeman—By Respondents—Direct

8761

The Witness: Wisconsin General Railway ceased to be a subsidiary of the North American Company on September 25, 1940, when its assets were transferred to its parent company, Wisconsin Electric Power Company.

By Mr. Hamilton:

Q. And is the stock of Wisconsin General Railway, as so representing an interest in this corporate shell still held by Wisconsin Electric Power Company? A. No, the stock of this company has been sold for a nominal consideration to a private individual who is not affiliated with the North American Company.

8762

Mr. Hamilton: May the record show that I have here handed to Commission's counsel certified copies of certificates of dissolution of all companies which have been referred to in Mr. Freeman's testimony as having been dissolved, and including, in addition, the four subsidiaries of Illinois-Iowa Power Company, as to which Mr. Van Wyck testified, and which are,—Bloomington & Normal Railway, Electric & Heating Company; The Brighton Electric Light and Power Company; The Decatur Light, Heat and Power Company; and The Elkhart Electric Light Co.

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Certified copies of certificates of dissolution of all these companies are so exhibited with the exception of Chicago & Illinois Valley Railroad Company, which, according to Mr. Freeman's testimony, was dissolved

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Herbert C. Freeman—By Respondents—Direct

in April, of this year, and for which, at this date, we have been unable as yet to secure a certified copy.

I see no point in burdening the record with these documents and I ask that the record may show that they have been examined.

8765

May I also add, that in the case of Washington & Glen Echo Railroad Company, the evidence of dissolution offered, or rather, exhibited, is a letter from the Maryland State Tax Commission, presented in photostat form, stating, among other things, that the charter of that company was forfeited on February 23, 1939, for nonpayment of taxes.

The Examiner: Off the record.

(Discussion off the record.)

By Mr. Hamilton:

8766

Q. Now, Mr. Freeman, what are the policies of the North American Company with respect to the operation of its holding company system? A. I believe, if I were to summarize those policies briefly, at this time, I would say that they were to build up a relatively few sound, well-organized and most efficiently operated public utility subsidiaries which would, and could, render the most efficient service at the lowest cost to the consumer, consistent with an adequate return on the capital invested; to make each one of those companies a part of its own community, with the most local-

—7,024—

ized management possible; to make each one of those companies a sound financial structure with protection for all classes of its security holders, and with adequate information

to those security holders on the operations of the company; to maintain full cooperation at all times with the local state regulatory commissions; to increase and develop the public use of and benefit from the services rendered by those subsidiary companies; to make sound long-time investments, with proper regard to geographical diversification for the North American Company, itself, and thereby to achieve soundness and stability for the security holders of the North American Company.

Now, those policies have been in force for a great number of years. I testified that I joined the North American Company in 1927 and those policies were in force for many years before that time, and, it is as a result of those policies that we have achieved the outstanding character of the utility subsidiaries of the company, and the outstanding services which they have rendered to the communities they serve. 8768

Q. Are the public utility subsidiaries of North American going to need financial and financing aid in the future?

Mr. Binford: That is objected to as calling for a guess or a conclusion from the witness. 8769

By Mr. Hamilton:

—7,025—

Q. From your knowledge, Mr. Freeman, as to the present operations, past developments and from your own knowledge as to prospects for future improvement, and having in mind the development of the art and state of the art, are you able to answer the question? A. I can say, confidently, that that will be the case. I think it is proper to draw conclusions from the experience of the past several years.

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Herbert C. Freeman—By Respondents—Direct

8771

At the present time, we are following somewhat the same pattern that was followed during the last war. There is a considerable increase in the demand for electric power and that is certain to call for investment of additional capital in the operating companies, but beyond that, the experience following the last war was that the requirements for capital to take care of the extraordinary increase in the demand for electric service over the decade following the war were very great. In the case of certain of our companies, the gross revenues over the ten years period following the war increased from two to three times, and having in view the fact that it has required, on the average, about \$5.00 of invested capital for every dollar of gross revenue, and that that ratio shows a tendency to increase, due to lower rates and to greater refinements of services demanded by the public, I think it is inevitable that all the companies will need very substantial amounts of capital within the next decade.

—7,026—

8772

Mr. Hamilton: That is all I have of Mr. Freeman, at this time.

Mr. Binford: In view of the limited nature of Mr. Freeman's statement, I will not insist upon my objection.

The Examiner: Very well.

We will recess until three o'clock this afternoon.

(Whereupon, at 1:00 o'clock, p. m., the hearing in the above entitled matter was recessed until 3:00 o'clock p. m. that same day.)

—7,027—

AFTERNOON SESSION

The Examiner: You may proceed, Mr. Hamilton.

Mr. Hamilton: I would like to submit, at this time, to the Examiner, a motion on behalf of the North American Company to dismiss certain parties to this proceeding, on the basis of the evidence heretofore introduced, and, with your permission, we will file an appropriate number of copies with you, at this time.

The Examiner: Very well. I will reserve the matter for the action of the Commission on this motion.

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(The documents in question were handed to the Examiner.)

Mr. Hamilton: I would like, also, if I may, to ask Mr. Freeman one or two more questions.

The Examiner: All right.

Whereupon HERBERT C. FREEMAN, a witness having been previously sworn, resumed the stand and testified further as follows:

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Direct Examination by Mr. Hamilton (Resumed):

Q. Mr. Freeman, is the North American Company engaged in the business of sending, or transporting, or causing to be sent, or transported, goods, merchandise, or services in commerce with foreign nations or among the several states, or any other kind of interstate commerce? A. No.

—7,028—

Q. What use of the mails, or other instrumentalities of interstate commerce, does North American Company make?

8776

Herbert C. Freeman—By Respondents—Direct

A. It makes use of the mails incidental to the business of a holding company.

Q. And what is its business as a holding company? A. The business of investing in, owning and holding securities.

Mr. Hamilton. Please mark this exhibit, consisting of four sheets, for identification as Respondents' Exhibit No. 130.

8777

(The document referred to was marked for identification as Respondents' Exhibit No. 130.)

By Mr. Hamilton:

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Q. What does this exhibit represent? A. The exhibit consists of a list of offerings of securities to the public through bankers, and to institutional investors from September 14, 1920, to January 18, 1933, the date of the last such offering prior to the passage of the Securities Act of 1933; also a list of offerings of securities to the public through bankers and to institutional investors from July, 1935, the date of the first offering subsequent to the passage of the Securities Act of 1933,—to date.

Q. I notice certain abbreviations appearing on the exhibit, such as "N. Y. S. E.". Will you state what those abbreviations refer to? A. That abbreviation appears under

—7,029—

the head of "Stock Exchange Listing", and it means that those securities are listed on the New York Stock Exchange.

Q. Has this exhibit been prepared under your direction, and have the facts shown been taken from the records of the

company? A. It has been prepared under my direction, and the information in it is derived from the records in the possession of the company. This relates to offerings of securities by the subsidiary companies.

Q. Does it include, for example, offerings by such intermediate holding companies as North American Edison Company and North American Light & Power Company? A. It does not include them.

Mr. Hamilton: I will offer that in evidence as Respondents' Exhibit No. 130.

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Mr. Binford: No objection.

The Examiner: The exhibit is so admitted in evidence.

(Respondents' Exhibit No. 130 was received in evidence.)

Cross Examination by Mr. Binford:

Q. Mr. Freeman, in what capacity did you first become associated with the North American Company? A. As Vice-President, and I became a Director and member of the Executive Committee at about the same time.

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—7,030—

Q. That was about April, 1927? A. I actually took up my position, I think, about the first of July, 1927. I may have been elected in April.

Q. Prior to your association with the North American Company, had you ever been associated with, or employed by, a public utility holding company? A. Only in the capacity of a public accountant; I had never been employed actually, as a staff employee of any holding company.

8782

Herbert C. Freeman—By Respondents—Cross

Q. In other words, such work as you had done in this connection had been as a public accountant and employed for a particular job, is that it, rather than in a continuous position. A. That is so.

Q. Had you specialized in holding company or public utility accounting? A. No, my public accounting experience was of a general, broad character.

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Q. I understood that from April 1921, until you became associated with the North American Company, you were connected with the National Cloak & Suit Company? A. That is true.

Q. Your work with that company was of an accounting nature, as well as of an executive nature? A. No, it was entirely in an executive capacity. The accounts were under —7,031—

the Comptroller or the Treasurer of the company; I had very little contact with it,—just as the other executives did.

8784

Q. Did you have experience in the flotation of security issues in connection with your work with the National Cloak & Suit Company? A. I don't believe there were any issues of that company while I was an executive of the company. I had had contact with certain security issues for that company as a public accountant. That company was a client of my firm.

Q. Prior to your association with the North American Company, had you actively participated in any other than an accounting capacity in the negotiation or flotation of any security issues? A. No, but of course my connection with security issues, as an accountant, had brought me very directly into contact, not only with the contracts involved,

but with the bankers, and I participated in a very great number of discussions with regard to statements and prospectuses and matters of that kind.

Q. Had you had experience in the preparation of documents in connection with financing to be submitted for the approval or examination of state security commissions prior to your connection with the North American Company? A. No, I had given testimony that was used in at least one case

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before a State Commission, but I do not recall that I was ever engaged in the preparation of documents to be filed with a Commission.

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Q. Well, you did not practice before any State Corporation Commissions, or Commissions exercising any regulatory jurisdiction over security issues, did you? A. No, sir.

Q. What, in general,—what was the scope of your duties when you first entered the North American organization as Vice-President? A. I became involved at once in the general activities of the company; I had no duties specifically allocated to me. All of us worked pretty much as a team there, and one was apt to be called in on almost any matter that came up.

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It is fair to say that on account of my previous experience, I was engaged more in finance and accounting matters and very little in operating matters.

Q. The Comptroller, for instance, would come more nearly into your jurisdiction than the engineering department, if there had been one at that time, isn't that true? A. Yes, I think that is so. When you say "jurisdiction", I had no actual authority with respect to the Comptroller,—the

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Herbert C. Freeman—By Respondents—Cross

Comptroller is a fairly independent officer, but in discussing accounting matters, he would, perhaps more naturally discuss them with me.

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Q. But there was no division, as among officers, of particular categories of the work of the company, is that true, as between the President and yourself, let us say. A. Well, there were certain natural divisions which resulted from the men's previous qualifications. Matters that had to do with operating or engineering questions would more naturally have been taken up with the President, Mr. Dame, who was an engineer, and Mr. Doolittle, Vice-President, who was an engineer. My contact with matters of that kind, particularly at the outset, would be quite incidental.

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Q. I believe you testified that you familiarized yourself with the purposes for which North American Company was formed, and with its activities prior to the time you became connected with it, through its records, and possibly other sources, after you became connected with the company,—that is true, is not not? A. That is true.

Q. Mr. Dame became President in 1921, did he? A. Yes.

Q. Whom did he succeed as President of the North American Company? A. I think he directly succeeded Mr. Mortimer, or Mr. Wetmore, I am not quite certain as to which of those two he succeeded.

Q. Was there any change in the personnel of the Board

—7,034—

of Directors of the North American Company in 1920 or 1921? A. In 1921 there was a very substantial change in the composition of the Board of Directors.

Q. Will you state what that substantial change was? A. My recollection is that Mr. Harrison Williams, Mr. Dame, I believe Mr. Anson W. Burchard, and Mr. Wells, became directors at that time. I don't recall what other changes there were.

I can furnish you with the details of that change, or those changes, if you wish, later.

Q. Would it be correct to say that there was a change at that time of the dominant personnel of the directorate and management, or of the directorate, anyway? A. Yes, I think that is so.

8792

Q. The gentlemen whom you named as having become members of the board at that time were newcomers to the system, were they not? A. Yes, they were.

Q. From your examination of the records of the company, and your inquiries into its history prior to your connection with it, are you able to state whether any changes of policy became effective after such change of control? A. I doubt if there was any really essential change in policy. What change there was probably related more to the building up of the local administration and management of the com-

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—7,035—

panies. Prior to that time, and at that time, of course, there were only two groups of companies involved, the St. Louis group and the Wisconsin group, and the chief executive officers of the North American Company had spent a good deal of time on the properties, and the properties were, to a much greater extent, managed by them than they were subsequent to that date.

8794

Herbert C. Freeman—By Respondents—Cross

Mr. Dame's policy was rather one of decentralization and of increasing the importance of the local administration.

Q. It was also a program of expansion, was it not, and the acquisition of new operating properties? A. There were acquisitions, following that date; I should say that they did represent a policy of further diversifying the interests of the company.

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Q. Or, in other words, not confining the interest of the company to two general geographical areas in which it had theretofore operated? A. That is true.

Q. Do you know what the number of the personnel of the North American Company was in 1920 or 1921, roughly? A. I haven't any idea.

Q. I believe you testified that at the present time there are eight officers and two assistant officers and ninety-nine employees. A. Yes.

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Q. Could you say whether in 1920 and 1921 the personnel was larger than that, or smaller? A. I don't actually know, but my belief is that it was probably smaller. After all, the number of companies involved was smaller and I know of no reason why there should have had a very large organization in proportion to the extent of the investment.

Q. Now, since 1921, has there been any change of personnel of the Board of Directors within any one short period comparable to the change of which we have spoken? A. No, nothing comparable to that change. The changes since then, have, in several cases, resulted from the death or retirement of individuals, the most definite change, I would say, has resulted from some of the implications of the Holding Com-

pany Act, but even so, it did not result in any such change in the Board as would represent a major change,—it was just related to certain individuals.

Q. There has been nothing in that connection which you characterize as a change of control? A. No, not of that class.

Q. Or the personnel of the control? A. No.

Q. Now, the gentlemen who came upon the Board of North American Company in 1920 and 1921 for the first time had not been active in the operation of public utilities, had they, or do you know? A. Yes. Mr. Dame certainly had been

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—7,037—

active in the operation of public utilities. Mr. Williams had been active rather in the holding company end, and not in the direct operations of utilities.

The others who came on at that time were men engaged in general business activities.

Q. And with the exception of Mr. Dame, they have not been engaged in the actual operation of utilities, that is, to the extent of any major portion of their time being devoted to such an activity? A. It is my recollection that is so. I don't know that I have told you all of the changes, I don't think I have, but I don't remember any others who would be regarded as operating men, although, now that I come to think of it, Mr. Robert Lindsay became a director at some time, it was in the early 20's, and he was, of course, an operating man,—he was President of the Cleveland company.

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Q. You have spoken of certain so-called investments of the North American Company, including some investments in the Pacific Gas & Electric Company.

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Herbert C. Freeman—By Respondents—Cross

Could you state, briefly and rather roughly, just what the service area of Pacific Gas & Electric Company is? A. It extends from the,—at the present time,—from, I think, Eureka, which is the most northerly part on the Coast in

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California, and that would be north central California, and the southern extremity in southern central California, would be about Bakersfield.

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Q. Is that in Santa Barbara County? A. I can't tell you what county, but about Fresno, Bakersfield, Merced, and so forth,—in the south central portion.

Q. Are the activities of that company, as a public utility company, confined to the State of California? A. Entirely.

Q. How far distant are the nearest portions of the territory served by it to the nearest point in the service area of any other company of the North American Company system—approximately? A. The nearest point would, of course, be the western extremity of the Kansas Power & Light properties, and I judge that is about 1,200 or perhaps 1,400 miles.

8802

Q. There is, of course, no connection of any kind between the physical facilities of Pacific Gas & Electric Company, and that of any other company of the North American System? A. No.

Q. And in the case of Detroit Edison Company, that service area is not contiguous to the service area of any other company in the North American system? A. Not actually

—7,039—

contiguous; of course we have properties in the State of Michigan, but in the northwestern area.

Q. Northwestern, and distinguished from the southern?
A. Yes.

Q. There are no transmission lines owned by any of the North American subsidiary companies which connect with any of the electric utility facilities of the Detroit Edison Company, are there? A. No, there are not.

Q. Nor do any of its transmission lines connect with any generating station of any other subsidiaries of the North American Company? A. No, sir.

Q. The utility operations of that company, namely, the Detroit Edison Company, are confined to the State of Michigan, are they not, and to the lower peninsula of that state? A. I believe that is so. I don't know whether they transmit any power across the state line or not. 8804

Q. Do you know, approximately, the size of the Detroit Edison Company, as indicated by its book assets? A. The property and plant are about \$325,000,000, I believe,—\$329,000,000; its total assets are \$363,500,000.

Q. Do you have similar figures with respect to the Pacific Gas & Electric Company? A. They are approximately \$700,000,000.

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Q. That figure represents— A. (Interposing) Property and plant, approximately \$742,000,000, and the total assets are \$790,000,000. 8805

Q. You spoke of the Sixty Broadway corporation. Approximately how much of the space in this building is occupied by the North American Company? A. There are two complete floors, and parts of three other floors, and the building, in all, has twenty-five floors.

Q. Except for the small proportion of space in this building which is vacant, the remainder not occupied by the North

8806

Herbert C. Freeman—By Respondents—Cross

American Company is occupied by persons not affiliated with the North American Company, is that true? A. That is true. May I qualify that? Are you using "affiliated" in a technical sense, or as I would use it?

Q. I don't know how you would use it, but suppose I am using it in a technical sense. A. By that I mean,—part of the building is occupied by companies who may, I believe, own more than 5 per cent. of the stock of the North American Company,—I am not quite sure as to that.

8807

Q. That is, who may, in the aggregate, own more than that. A. Yes.

Q. Would you name those companies, please? A. That would be Central States Electric Corporation, American

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Cities Power & Light Corporation, and Blue Ridge Corporation.

Q. Does Mr. Williams also have an office in that building,—individually? A. Mr. Williams, as Chairman of the Board of North American, is furnished with an office by the company.

8808

Q. But he has no office separate and apart from his offices furnished as Chairman of the Board? A. Not individually, I think. I don't know of any office apart from that which the North American Company provides for him.

Q. I believe you testified that twelve stories of that building are occupied by the Hanover Bank & Trust Company? A. That is true.

Q. I think you further testified that one purpose which existed in respect to the acquisition of this building, and one result achieved was the creation of a hedge against possible

advances in rentals in the district in which the building is situated, is that true? A. That is what happened. It was bought because it was thought that it would be a good investment, and the fact that it was a good investment was what resulted in its acting as a hedge against increasing rental costs.

Q. Would you say the word "hedge" was appropriate there. As a matter of fact, isn't the gamble about the same

—7,042—

when you buy the building as it is when you have to be on the other side with respect to renting from time to time,—would you consider that a real hedge? Aren't you just as liable to be holding the equity when rents are low, and lose in that respect, as you would be if you were renting, and might have to meet the disadvantages of higher rent, but also receive the advantages of low rent periods? A. Well, an investment situation is always apt to change.

8810

Q. Yes. A. And has changed in real estate in the past several years, and in the years following the acquisition of Sixty Broadway, there were times when a great many people were buying buildings purely to be sure of having an office.

8811

Q. But rather as a hedge, since you assumed that ownership would be more profitable than depending on rate changes for the composition of your rent expenses, isn't that right?

A. There is more involved than that. You can't always be shifting your office just for the purpose of getting the best rent that is available, and the fact that you do own a building gives you what amounts to a hedge against unreasonable rentals. It protects you from the necessity of moving from time to time, and particularly in a case such as Sixty Broad-

8812

Herbert C. Freeman—By Respondents—Cross

way where you have long leases with very large and responsible tenants, it very definitely serves the purpose of a hedge which is protected to a very great extent on the down side.

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In other words,—

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Q.^d (Interposing) You believe that the disposition of No. Sixty Broadway, at the present time, would result in a loss to the North American Company? A. I feel that it would, based on the general situation with respect to real estate in financial New York.

The thing that might militate against that, to some extent, is the existence of these long term leases. In other words, a purchaser who perhaps would not look at another building at all might look at Sixty Broadway at the present time, but I don't think he would be apt to pay us as much as our investment in the building amounts to.

8814

Q. As to that, possibly the advantage of the hedge, if you call it that, may have been offset by the decrease in the capital investment in so far as it is recoverable. A. If we were forced to liquidate at this time, that might be true.

Q. Do you foresee, or anticipate, a change of conditions which might enable you to dispose of the building on more favorable terms? A. Personally, I cannot see that the financial situation is going to remain as stagnant as it is at the present. If this country is going to progress, we are bound to have more financial activity, even in New York City, and when that happens, the value of Sixty Broadway will come back.

—7,044—

Q. But if you sold now, I am referring to Sixty Broadway property, the result would be rather the enforced recordation of a loss already sustained upon your books; wouldn't it be the realization of a loss that actually has been suffered by reason of the decrease in realty values? A. We are perhaps caught in a cycle that affects real estate in New York City, and if you liquidate any investment at the bottom of a cycle, you are bound to sustain a loss. Real estate in New York is practically at the bottom of the cycle, there may have been just a very slight improvement, but it is an improvement more in tenancy than it is in rentals. But I don't think it is fair to look upon any investment in view of what it might bring at the bottom of a cycle such as that.

8816

Q. You have characterized this present period as the probable bottom of a cycle, in the ordinary sense of a business cycle? A. I believe that based on the general improvement in business activity which I think will eventually be felt in real estate.

Q. You have spoken of the West Kentucky Coal Company and its subsidiaries. I believe you stated that in that case, also, a present sale would necessarily entail the realization of a substantial loss on the investment of North American Company, is that true? A. I believe that it would.

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—7,045—

Q. Do you anticipate a change of conditions which would enable the North American Company to realize a greater proportion of its investment, or a larger proportion than at the present, in the realization of this property in the near future? A. How near in the future that might be when that would come about, I could not say. There is a very sub-

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Herbert C. Freeman—By Respondents—Cross

stantial value in the assets of that company. The realizable value depends,—or is bound up so much with general business activities that I think it would only be in a period of fairly good general business activity that we should be likely to be able to realize anything like the value at which we carry it on the books.

8819

Q. Would you say that at the present time, under existing legislation, the ownership of West Kentucky Coal Company benefits any of the operating utility subsidiaries of the North American Company,—that is to say, the ownership by North American Company of this coal property? A. It is hard to say whether there is an element of benefit there. If there is, it is possibly a psychological benefit based on some improvement in trading position which it may give to our subsidiaries.

Now, as I suggested, the fixing of prices for coal somewhat militates against that, but if there should be a stop

—7,046—

in the coal supply, I mean strikes, or causes of that kind, the ownership of those mines might be very important.

8820

Q. Now, are you familiar with the reasons which impelled the management of the North American Company to make their investment in 1925 which resulted in the obtaining of control of Western Power Corporation? A. I think the investment was made because it was regarded to be a favorable form of investment for the company. I don't think there were any reasons which impelled them, as you say, other than that. There was a situation there in which there was obviously the opportunity for the building up of a great property and they took that opportunity and made

the investment, and then, having completed their job, as it were, in that property, they carried it through to the logical conclusion and sold it to the one company with which it could be integrated to a very great advantage to both the Pacific Gas & Electric properties and to the properties of Western Power.

Q. Well, there was no loss sustained by the North American Company either? A. Regarding the proposition as a whole, there was a very substantial profit.

The Examiner: Let us have a short recess.

(Whereupon, following the taking of a short recess, the hearing was resumed.)

—7,047—

Q. When was the sale of the California property, controlled by North American, made to Pacific Gas and Electric Company? A. The basis of the transaction was agreed to in March 1930, but there had to be certain commission approvals obtained and the completion of the transaction was early in June 1930.

Q. During that period of approximately five years in which control was exercised by North American Company over the Western Power Corporation properties a program of expansion and construction was carried out, was it not? A. It was.

Q. And capital was furnished in large part by the North American Company? A. Entirely by the North American Company. My recollection is that the North American Company increased the investment in subsidiaries of Western Power Corporation by upwards of \$23,000,000 during that

8824

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period in the form of capital or advances and those advances were canceled at the time of the sale to Pacific Gas and Electric Company.

Q. And the facilities so erected were in large part in competition with those of Pacific Gas and Electric Company?

A. The greater part of them were, yes. There was some expansion in the southerly properties which were not in direct competition with Pacific Gas, but the development in

—7,048—

8825

the northern properties was directly in competition with them and of course the tie-line between the northern and southern properties might be regarded as somewhat in competition.

Q. So that a point was reached at which it was obviously in the interests of economy, taking the two systems together, that the Pacific Gas and Electric properties and those so controlled by the North American Company be operated together, is that true? A. Yes, from the point of view of economy, and I think in the public interest. There was economy of course not only in the elimination of competition

8826

but in the actual operation of the property.

Q. And you would say the North American Company was largely responsible for bringing this condition about, as well as for bringing about the actual integration in respect to ownership of the two sets of properties? A. I would say the North American Company had a very large part in that. It was naturally of mutual advantage and both sides worked on it to bring it about.

Q. Didn't the management of Western Power Company, prior to the time the North American Company made its in-

vestments in that company, have a program of expansion upon that later developed by the North American Company?

A. I have no knowledge as to that.

Q. You don't know that as far back as 1922 such a

—7,049—

program had been discussed and considered by the officials of the Western Power Corporation? A. Of the Western Power Corporation?

Q. Yes. A. That was—

Q. (Interposing). Or the Great Western, the companies then in control of the properties acquired by the North American Company in 1925. A. Perhaps I didn't understand your question. I thought you asked me if I knew that the Pacific Gas and Electric Company had expansion plans.

Q. No; the other company. A. I beg your pardon. I think I testified yesterday that these expansion plans had to a large extent been under way at the time we made our investment, but it was the opportunity for the investment which those plans required which made the purchase to a large extent attractive to the North American Company. In other words, there was a big development job to be done, and if it was done well it would in all probability be a profitable one.

Q. Would it be an unfair statement to say that the North American Company was influenced in its investment in the Western Power Corporation properties by the probability that through its ability to furnish additional capital for construction purposes it could create a physical situation in

—7,050—

territory served by Western Power Corporation wherein a

8830

-Herbert C. Freeman—By Respondents—Cross

sale on a profitable basis to Pacific Gas and Electric Company would be almost a foregone conclusion? A. No, I don't think that would be a fair statement. Those two companies could run along on an independent basis almost indefinitely.

8831

Q. This wasn't, then, a 5-year adventure out there, made in the hope of so building up the Western Power properties that they might be sold at a profit to Pacific Gas and Electric because of the increasing competition which they afforded to Pacific Gas and Electric? A. Not to my knowledge. I don't think that was the controlling interest in any sense.

Q. Nor do you think it was a factor in the determination to make the initial investment? A. No, not to my knowledge.

8832

Q. Reverting again to the organization of the North American Company, would you please state the names of the eight officers of the North American Company and their respective positions? A. Mr. Harrison Williams, Chairman of the board of directors; Mr. E. L. Shea, president; Mr. J. F. Fogarty, chairman of the executive and finance committee; Mr. F. H. Piske, vice president and treasurer; Mr. Ralph E. Moody, vice president; myself, Herbert C. Freeman, vice president; Mr. Reed Hartel, secretary; Mr. P. D.

—7,051—

Preger, controller.

Q. And the two assistant officers, will you state their names and positions, please? A. Mr. R. K. Nunn, assistant treasurer, and Mr. J. C. Johansen, assistant secretary.

Q. Which of these men whom you have named have had public utility engineering experience? A. Mr. Ralph Moody.

Q. Any others of the officers or assistant officers? A. No.

Herbert C. Freeman—By Respondents—Cross

8833

Q. How are the 99 employees of North American Company classified in regard to their functions? A. There are 22 employees in the controller's division; four in the treasurer's division; 37 in the secretary's division; 19 in the stock transfer division; 8 in what we call the operating division; and there are 9 executive secretaries.

Q. What are the duties of the 8 persons employed in the so-called operating division? A. They keep in touch with matters of construction budgets, matters of that kind. They include a rate expert; they include, for example, Mr. Lindseth, who has testified in this case, and who is assistant to Mr. Moody. They are the people who are more directly involved in keeping in touch with the reports which come in from the subsidiary companies, other than those of a purely

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—7,052—

accounting character.

Q. Would you state the names of those eight persons and their respective titles, if any? A. I can give you the name of five of those; the other three are secretarial and filing help and people of that kind. The five are Mr. Elmer L. Lindseth, Engineer; Mr. W. C. Heise, Engineer; Mr. Charles E. Neil, rate specialist; Mr. Earl C. Sandmeyer, executive assistant; and Mr. E. M. Thierry, assistant to the president.

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Q. This division is under the supervision of Mr. Moody, is it? A. Yes; in that connection, though, Mr. Sandmeyer and Mr. Thierry report also directly to Mr. Shea, the president of the company.

Q. How long has Mr. Shea been president of North American Company? A. Since early in 1940; I can't remember the exact date.

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Q. In what business was he engaged prior to the time he became president of the North American Company? A. He was an executive officer of one of the large oil companies.

Q. Had he ever been an executive officer of any utility company or utility holding company, so far as you know? A. So far as I know he had not.

—7,053—

8837

Q. You have testified as to assistance given by the officers of the North American Company in connection with certain financing by subsidiary companies; in cases in which such assistance has been given has it been the usual custom of the North American Company to secure the assistance of counsel by which I mean attorneys at law in connection with such financing? A. Counsel for the North American Company has, I believe, in almost every case either attended to the legal details or has been in touch with the legal details, together with counsel for the individual operating company.

Q. Where would you draw the line between legal details and other details in such a connection? A. Did I mention other details?

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Q. No, but I did. What would you say were the legal details as distinguished from any other details? I thought you mentioned legal details. A. The other details involve the development of the plan of financing, the determination of the time, the determination of the bankers to head the syndicate, and the composition of the syndicate, the supervision of the preparation of all the necessary applications and registration statements, financial statements, discussions with bankers and the eventual of negotiation of the terms; assistance in appearances before regulatory bodies, the arrange-

ment of the details of closing. I think that about covers it.

—7,054—

Q. What officers of the North American Company usually appear before regulatory bodies on behalf of subsidiaries? A. I don't think that officers of the North American Company have appeared before any regulatory bodies in connection with actual financing. Those appearances are made by the executive officers of the subsidiary companies themselves, but the North American Company officers have very frequently discussed financing in a preliminary way with, for example, the Securities and Exchange Commission. They have also made appearances—I will mention just one instance—before the Wisconsin Commission, for example, in connection with the financing in 1938. Mr. Doolittle appeared on behalf of the North American Edison Company in connection with the transaction under which the old Milwaukee Electric Railway and Light Company acquired Wisconsin Electric Power, and that, of course, was one of the details of the financing at that time.

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Otherwise the service which the North American Company renders is in the preparation for the appearances and the ground work which is laid for them.

8841

Q. Are you familiar with the work of any of the so-called independent service companies in the public utility field?

A. No, I am not.

Q. Therefore you do not feel competent to make any comparison or contrast with the work performed by the North

—7,055—

American Company in respect to its subsidiaries on the one hand, with, on the other hand, the work done by such service

8842

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companies for their clients? A. My only basis of comparison would be the importance of the transactions involved. I don't know of any important cases in which those services have been engaged that would compare with the financing operations of our subsidiaries.

Q. Now you know Mr. Van Wyck who assisted in this case? A. I know him very well.

Q. Have you read his testimony in this proceeding? A. Yes.

8843

Q. Do you know whether or not there is any present member of the personnel of the North American Company who has had experience in indentures and indenture financing comparable with what Mr. Van Wyck has recited as his own experience in that respect? A. Not in the technical details of setting up the indenture. I think from the point of view of the principles to be covered in the indenture and the points to be safeguarded, Mr. Fogarty's experience is equal to that of Mr. Van Wyck's and Mr. Pisky has had very considerable experience along those lines, and I myself have had about 14 years of experience dealing with those questions, but Mr. Van Wyck's experience has been somewhat unique because as counsel he has been engaged in the actual

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—7,056—

drafting of the provisions. We act only as critics of the provisions after they are drafted, and as people to suggest provisions and modifications of existing provisions.

Q. Since Mr. Van Wyck's assumption of his present duties with the North American Light and Power Company has the drafting of indentures of North American subsidiaries which are not subsidiaries of North American Light

and Power Company been left more largely to counsel than was the case while Mr. Van Wyck was still active among such other subsidiaries of the North American Company? A. I think Mr. Van Wyck has had a great deal to do with the drafting of the Union Electric indenture and I think of some of the papers in the Wisconsin Electric financing. He has testified to that. Apart from that the rest of us, as I say, have rather acted as critics; the actual drafting has been done by counsel, both Sullivan and Cromwell, and counsel for the individual operating companies.

8846

Q. The North American Company as such is not subjected to regulation by any regulatory body other than the Securities and Exchange Commission, is it? A. I don't know that it could be called a regulatory body. Of course we are subject to the laws of the State of New Jersey, corporation laws. We have to comply with the requirements of the New York Stock Exchange, but there is no governmental body

—7,057—

which exercises regulatory supervision of us.

Q. You submit no reports to any public utility commission or any State or to any commission of any State occupying a situation in respect of utilities such as is ordinarily occupied by a public utility commission or public service commission? A. No.

8847

Q. So except as you have stated, the nature and extent of the expenditures of the North American Company and of its activities is not subject to restriction or regulation by any State bodies, governmental bodies? A. The nature of its expenditures I would say is subject to regulation and restriction by the Securities and Exchange Commission, but otherwise there is no regulation.

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Q. I believe you stated that the North American Company officers and personnel assisted the managements of the several subsidiary public utility companies in respect of appearance before State regulatory bodies, is that correct?

A. I don't believe I said so much in connection with appearances, but we have reviewed the applications filed by the various subsidiaries with the various State regulatory bodies in connection with financing and matters of that kind. I think there may have been other occasions where we have assisted in actual appearances. The one I mentioned of Mr.

—7.058—

Doolittle's appearance is one, but at the moment I can't recall others.

Q. But you would feel free to do so if you considered that the interest of the subsidiary involved and the interest of the North American Company, isn't that true, in the absence of any positive law or regulation to the contrary? A. I don't think the question has ever come up. I don't know what standing we would have before a State regulatory body unless we were in some way a party to the transaction and as to that we have always stood ready to appear wherever it was necessary, but the matters presented to the Commissions in which we were parties on one side as, let us say sellers of securities, have always been sufficiently explained in the papers filed and by the appearances of the subsidiaries themselves, and to my recollection it has not been necessary for us to make appearances. I might mention one instance where the tax commission of the State of Wisconsin called for our service in connection with the taxes of the Wisconsin Company, but that was an isolated case, as far as I have any knowledge.

Q. Does the North American Company engage in any activities directed to the benefit of public relations between its subsidiaries and the public served by them? A. We try to advise them on matters of reports and relationship with stockholders and with the public, but chiefly through the

—7,059—

medium of their reports. Mr. Thierry whom I have mentioned deals with all of our own reports and stockholder correspondence, and matters of that kind, and the building of good relations in that way, and he reviews all of the reports and statements made by the subsidiary companies and looks at them from that point of view, and gives them the benefit of his experience.

8852

Q. Is the North American Company a member of or does it contribute to any association or other organization which carries on any campaign or publishes any literature designed to improve the relations existing between consumers and public utility companies? A. No.

Q. Mr. Freeman, will you please turn to Respondents' Exhibit 125, at page 68? This page purports to be a schedule of certain debit balances of combined loan advance accounts of operating subsidiaries of the North American Company, Wisconsin Edison Company, Inc., and North American Edison Company, for the years more particularly set forth in the caption to the table. With respect to the advances and loans which are reflected in part by this table, was it the custom of the North American Company to charge interest upon the advances so made? A. Yes.

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Q. Can you state the rate of interest and the manner in which the same was determined? A. During the period from

—7,060—

8854

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1915 to the middle of 1920 the general practice was to charge interest on advances at the rate of 6 per cent. per annum, but from October 1915 to October 1916 the rate in some cases was 5 per cent. per annum. From August 1920 to April 1922, following the rise in interest rates which began about the middle of 1920, the rates charged were in excess of 6 per cent. They averaged approximately $7\frac{3}{4}$ per cent. in seven months during this period, and went as high as $8\frac{1}{8}$ per cent. during five months of the period.

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During the last nine months of 1923 the rate charged was $6\frac{5}{8}$ per cent. In the latter part of 1930 the rates were reduced from 6 per cent. to $5\frac{1}{2}$, 5 and in some cases $4\frac{1}{2}$ per cent., but during 1928 and 1929 when call money rates were very high the charge to subsidiaries was restricted to 6 per cent., which was substantially lower than the call rate.

Q. What was the latest period covered in your statement just made as to interest rates? A. This covered the period down to 1930. Subsequent to 1930 the only substantial advances were those to Union Electric Company of Missouri. I have no record with me of the rates charged to that company since 1930, but my recollection is that it was not more than $4\frac{1}{2}$ per cent., but I shall be glad to furnish that for you if you wish to have it.

8856

Q. Are there any present advances due to the North
—7,061—

American Company from its subsidiaries? A. There have been no advances to subsidiaries since the end of 1935.

Q. Are there any amounts presently owing on account of advances made to subsidiaries? A. No. I meant to imply that in my answer.

Q. Then in respect to advances the table which you have submitted comprises all matters which would be shown upon it according to its caption, even if the date were extended to 1935, to the present time? A. That is correct.

Q. Now I asked you relative to the interest rates charged by North American Company, as to what those rates were and how computed. I believed you answered what they were but did you answer as to how the rate was arrived at? That is to say, was it the ordinary rate for commercial bank loans prevalent at the time of the advance, or at the time of the collection of the interest, or how was it determined? A. It

was somewhat in excess of the rate which the North American Company paid during part of that period when it was a borrower. Up to 1923 as compared with the rates which I have mentioned there was a differential of about 1.2 per cent. in favor of the North American Company. From 1924 to 1935 the North American Company was not so apt to be a borrower during that period. During that entire period the

—7.062—

average of the rates charged to subsidiaries was just over 5½ per cent. and the average paid by the North American Company during those months in which it was itself a borrower was 5.7 per cent.

Q. When you speak of periods during which the North American Company was itself a borrower, you mean to exclude only borrowings, current funds, rather than upon funded debt? A. Yes. I am afraid I made a misstatement in that last answer. What I meant to say was that the average rate charged to the subsidiaries during the months during that period from 1924 to 1935, when the North American

8860

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Company was itself a borrower, was 5.7 per cent., but the rates paid by the North American Company on its borrowings in those months, which were not a great part of the period, averaged 3.9 per cent., so that in those particular months there was a differential in favor of the North American Company of 1.8 per cent.

Q. When you speak of the rates paid by the North American Company you mean the rates paid upon bank loans as distinguished from rates paid upon funded debt as represented by debentures? A. That is true; during that period the North American Company of course had outstanding debentures on which it was paying 5 per cent. That is during part of that period.

Q. The table of which we have been speaking includes accounts due to Wisconsin Edison Company, Inc., and to the North American Company, as well as to the North American
—7,063—

Company. What policy was pursued by the Wisconsin Edison Company, Inc., with respect to interest collected by it upon advances of the character here shown to its subsidiaries? A. The statement I have made is intended to apply to all of the advances during this period. I don't think there was any difference in the treatment by the three companies.

Q. Was the rate of interest charged to subsidiaries determined by the addition of an overage or additional figure to the rate paid by the parent company making the advance? A. No, not specifically.

Q. You speak merely of the relations borne and not of the method of determining the rate itself, then? A. I don't think there was any specific differential that was applied but

the fact that a differential was justified was considered because the North American Company was, of course, borrowing on loans with a definite payment date, whereas its advances to subsidiaries might run on almost indefinitely until the company to which the advance was made was in a position to finance or until the North American Company itself took common stock against the advances which it had made.

Q. In this table to which we have been referring, balances favorable to the advancing companies are all that are shown. Is it true that from time to time the debit bounced around the other way, that is to say the subsidiary companies would

8864

—7,064—

have on deposit funds with the parent? A. There were periods during which some of the subsidiaries had credit balances.

Now was interest paid upon those credit balances by the North American Company? A. Yes.

Q. Could you state the rates at which that interest was paid? A. The rates varied from time to time during the period. In 1915 they were credited with interest at three per cent. There was one month there where the rate varied or the rate was in some cases $2\frac{1}{2}$ per cent. In 1916 and 1917 where there were advances, where there were credits, the rate was $2\frac{1}{2}$ per cent. In 1919, 1920 and 1921 the rate was in some cases 2 per cent.; in other cases $2\frac{1}{2}$ per cent., but in certain cases during 1921 the rate was as high as 7.8 per cent. That was on, I think, balances held for short periods for use in the call money market.

8865

In 1922, 1923 the rates varied from 2 to 3 per cent. They became 3 per cent.—there was nothing lower than three per

8866

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cent. at the end of 1923. 1924 and 1925 and 1926 they varied from 2 to 3 per cent. up to the middle of 1926. The latter part of 1926 they varied from 2 to 4.8 per cent. 1927 they varied from 2 to 4.4 per cent. In 1928 they varied up to as high as $8\frac{1}{8}$ per cent. 1929 up to 9 per cent. That was
—7,064a—

8867

during the period of high rates in the call money market. In 1930 the call money market dropped very appreciably and the rates varied from 2 during the most of the year up to $4\frac{1}{4}$ per cent., and during the latter part of the year down to as low as $1\frac{1}{2}$ per cent. That was when the call money rate was 2 per cent.

8868

In 1931, 1932 the rate varied from something over 2 per cent. to $1\frac{1}{2}$ per cent., 1 per cent.; at the end of 1932 the call money rate dropped to 1 per cent., and there was a credit in that month of $\frac{1}{2}$ of 1 per cent. In 1933 there were only credit balances during the first three months of the year. The first two months credits were $\frac{1}{4}$ of 1 per cent. against a call money rate of 1 per cent., and in March for some reason the call money rate went up to 3.3 per cent. and the credit was at the rate of 2.9 per cent.

During that period the intention was to follow the call money rate on cases where the deposit was left with the North American Company primarily for use in the call money market, where they had surplus funds.

Q. To follow the call money rate but not to equal it?

A. But not to equal it; no, it was somewhat below the call money rate.

Q. Roughly, could you say about how much below the call money rate the average rate paid upon such deposits

was during the period of high money rates? A. Well, I can't

—7,065—

give the call money rates back of 1920. They are not readily available. In 1921 I have a record of some call money rates; for example, in January and February when we allowed some of our companies as high as 7.8 per cent., call money rates were 6.7 per cent. and 7.2. Later months during the year the call money rates averaged 5.5 per cent.; one month 5, another month a little over 5 per cent., and during that period whatever the credit balances were we were allowing only 2 to 2½ per cent. In 1922 and 1923 the call money rates varied from 3¾ per cent. up to 4.9 per cent., and 5.1 per cent. in 1923.

8870

I have mentioned call money rates in some of the years from 1924 on. We really began to follow the call money market reasonably closely in 1928 when it began to go up. In that year there were differences of from 2/10 of a per cent. to a little less than a half of one per cent. between the rates allowed and the call money rates.

In 1929 there were differences of varying amounts. For example, in January when the call money rate was 7.5 per cent. the rate allowed was 6.4 per cent., and in July when the call money rate was 9.23 per cent. the rate allowed was 8.47. After that the call money rates began to drop and the variation between the rates credited and the call money rates in some cases disappeared, and in other cases was not more than 1/2 of one per cent.

8871

—7,066—

Q. How did the aggregate of deposits by the companies with their respective parents, that is the North American Company and the other two companies which appear on the

8872

Herbert C. Freeman—By Respondents—Cross

caption of the table we have been discussing compare with the aggregate of advances on loans made to the subsidiaries by the parents? A. There were only three companies which had—perhaps I should say four—credit balances for any extended period, from 1915 to 1935. The Milwaukee Light, Heat and Traction Company, which was one of the constituent companies in the Wisconsin area had balances in 1919, '20 and '21 ranging from \$871,000 to \$947,000. In '22 and '23 those dropped to \$117,000 and then disappeared.

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The St. Louis County Gas Company had credit balances from 1925 to 1931. They were of no consequence after 1929, when they were \$293,000. The highest balance was \$745,000. Union Electric of Missouri prior to the period when our advances to that company began to be very heavy had credit balances during a period of years from 1922 to 1928. They varied in amount from \$849,000 in one year, and in one year, 1928, they amounted to \$9,258,000. The Wisconsin Electric Power Company, which also had had debit balances over a long period of years, up to 1928, had credit balances from 1929 to 1932. Those varied from \$3,429,000

8874

in 1932 to \$8,510,000 in 1929.

Now that company had developed credit balances in two

—7,067—

earlier years. Wisconsin Gas and Electric Company had a credit balance in one year, 1929, of \$3,813,000, but in the early years this company had debit balances. Those are the main facts.

Q. I assume that from time to time situations would exist in which one of the subsidiaries would have a credit balance and another one would have a debit balance at the same time, is that true? A. Yes, in some years that was so. The dif-

ference between the two cases being that we had to stand ready to pay them the credit balances whenever they called for them. It would have been more difficult for us to collect the balance from the company which owed us the money; we might have had to take common stock for it; it would depend entirely upon their ability to finance at that particular time.

Q. I suppose since these companies were subsidiaries you would have some voice and consideration with respect to when they made their calls, would you not? A. Not entirely. After all, they have to provide facilities and they are not in position always to delay the building facilities. They may have to have the money.

8876

Q. Would it be correct to say that prior to 1935 any substantial portion of the income of the North American Company was derived from interest charged upon advances and loans to subsidiaries? A. In excess of interest paid, you
—7,068—

mean?

Q. I didn't include that deduction; without including that deduction if they were properly deductible. A. I haven't any actual figures to show that but it is obvious that based on the amounts of the advances shown in the exhibit, page 68, that the interest received by the North American Company could not have represented a very large proportion of its income. After all, until we get up to the year 1932 the aggregate did not exceed \$17,000,000. At that time it appears that we were charging approximately 5½ per cent. on the average, covering a period. I don't know what the rate was in the year 1932 itself, but I should think, based upon what I have testified with regard to the year 1931, that it was probably lower than 5½ rather than higher, so that in that

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Herbert C. Freeman—By Respondents—Cross

particular year the interest on \$17,000,000 would have amounted to about \$935,000, and at that time the total income of the North American Company was probably in the neighborhood of \$25,000,000.

Q. Of course the overage between the amounts paid as interest upon deposits made by subsidiaries with the North American Company and the rate at which the North American Company was able to place that money in the call market, was also income to the North American Company?

8879

A. Not also income; that would be included in the amount which I have mentioned. That was the gross.

—7,069—

Q. I was speaking before the gross income received by the North American Company from interest paid by its subsidiaries to it by reason of advances made by the other subsidiaries. I am now speaking of the other side of the picture, the profit to the North American Company in the reloading upon the call market of money obtained from its subsidiaries at a lower rate; that also was a factor in the North American gross income, was it not? A. Yes, during the period

8880

when we were lending money in the call market, but that was not a very extended period. I have given figures showing the call money rates as applied to rates which we were crediting to subsidiaries over a long period, but we were not lending money in the call market during all of that period. My impression is that we probably only had call money loans out in two years during that period.

The Examiner: It is now 5:15 and we will recess until 9:30 Wednesday morning.

(Whereupon at 5:15 p.m. the hearing adjourned until 9:30 a.m. Wednesday, April 9.)

—7,070—

2961

BEFORE THE

8881

Securities and Exchange Commission

DOCKET NO. 59-10

IN THE MATTER

of

THE NORTH AMERICAN COMPANY, *et al.*

7

8882

Hearing Room 1101,
Securities and Exchange Commis-
sion Building,
18th and Pennsylvania Avenue,
N. W.,
Washington, D. C.,
Wednesday, April 9, 1941.

Met, pursuant to adjournment, at 10:00 o'clock, a. m.

8883

Before: WILLIAM W. SWIFT, *Trial Examiner.*

Appearances:

S. PEARCE BROWNING, JR. and CHARLES S. HAMILTON, JR.,
of Sullivan and Cromwell, 48 Wall Street, New York,
New York, appearing for the North American Company,
et al., Respondents.

RALPH C. BINFORD, appearing for the Securities and Ex-
change Commission.

—7,071—

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Herbert C. Freeman—By Respondents—Cross

PROCEEDINGS

The Examiner: Let us proceed, gentlemen.

Whereupon, HERBERT C. FREEMAN, a witness called on behalf of the Respondents, having been previously sworn, resumed the stand and testified further as follows:

Cross Examination by Mr. Binford (Continued):

8885

Q. During these periods of high call money which you have mentioned, would it be correct to say, Mr. Freeman, that the North American Company acted as a conduit by which the subsidiary utility companies, having available cash, were enabled to place such cash on favorable rates of interest in the money market in New York? A. I don't think I would characterize it in that way, because I don't recall to what extent the North American Company actually placed money on the call market at that period. My recollection is that it didn't amount to very much.

8886

Q. It was sufficiently substantial, however, to cause the management of The North American Company to feel that they could afford to pay interest to the subsidiaries on this so-called deposit at a rate measured in part, but lower than the call money rate? A. I think the feeling rather was that whatever happened in the call money market, that the rate

—7,072—

of interest should bear, at that particular time, some reasonable relation to the call money rate.

Q. But you do not recall why the feeling existed? A. I can't say to what extent money was placed in the call money

market at that time; the amounts involved, after all, are not very great.

Q. The tendency of high call money rates, in its effect upon subsidiary utility companies which might have a choice between the employment of funds for the development of their utility systems, or the employment of such funds in the call money market through the North American Company, would be to cause the management of the subsidiary utility companies to place their funds at this high rate of interest, rather than to employ them for the additions and betterments to their systems, would it not? A. I don't think that would be a controlling factor. Utility companies must make additions and betterments, and, in good time, before the demand develops, and they would be guided rather by the question of cost of construction at the time, and the particular time when the demand would be likely to develop, rather than by what the money might earn as money.

8888

Q. Isn't there normally, however, a marginal field within which improvements and betterments do not have to be made and funds which can be employed profitably elsewhere are consequently not drawn upon?

—7,073—

8889

Mr. Hamilton: Will the reporter repeat that question?

(Whereupon, the pending question was read by the reporter.)

By Mr. Binford:

Q. (Continuing)—that is, for the purpose of betterments and improvements. A. I don't know just what you mean by "normally a marginal field"; the situation usually is that

8890

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the utility company tries to provide capital to meet its requirements over a reasonable time in the future,—that time may be a longer period or a shorter period, according to the money market at the time, and according to the rapidity at which the demand develops,—by that I mean, utility companies may, if the money market is favorable at some time, finance a little ahead of the requirements, and at other times, they may, because of favorable construction costs, develop a little ahead of the immediate requirements. I don't think there is what you might call a normal condition there. The condition has to be met from time to time.

8891

Q. Possibly I can illustrate that by an example:

Let us suppose that a utility company feels that the improvement of a certain transmission system, or line, is desirable for future development, but not essential to be made at any given moment. Suppose, further, that such utility company has on hand such available cash with which to make the intended improvement. Now, isn't it true that the man-

—7,074—

8892

agement of a utility would be less likely to expend that money at the present moment, let us say, in the improvement of this transmission line, and the consequent possible increase of its rate base, if it can temporarily employ these available funds at, let us say, 7 per cent., or some figure higher than the rate base in the call money market? Wouldn't the inclination be to defer making the improvement while that opportunity for a large interest existed with respect to these available funds? A. I still say, in spite of your example, that the rate of possible earnings on cash, as cash, would not be a controlling factor.

After all, all of us in the industry are utility-minded; we are not thinking of those things from the point of view of lending money; that is not our function, and I don't believe any management would speculate on the possible cost of construction changes during a period when it might manage to earn a few hundred or a few thousand dollars on money that was lent out at call money rates.

Now, by that I don't mean that they will rush in and do construction work that is not needed, and I believe the record of all our companies shows that they do attempt to finance their requirements ahead of the demand actually developing. That, at times, means that they have a certain amount of cash on hand, and naturally, if there is an opportunity to use that cash, they use it to the best advantage, entirely con-

—7,075—

sistent, however, with its requirement for utility purposes.

Q. You indicate that the management of The North American Company has not been interested in the loaning of money, primarily, but primarily in the utility interest prices. Nevertheless, the functions which the North American Company has to perform in regard to making advances to subsidiaries is shown by the exhibit to which we have been referring, and in the receipt of the so-called deposits from such, somewhat approaches commercial banking, or did it not, during such a period. A. No, I don't think it at all approached that kind of business.

Q. Except for the restricted clientele, what restriction could be drawn? A. No, we did not advance this money to our subsidiaries primarily from the point of view of what that money would earn as money; we were thinking of providing our subsidiaries with the capital that they required

8896

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for their construction and other needs, from time to time, under conditions which would enable them to finance their requirements permanently to the best advantage at some time in the future, knowing that in the last analysis, if they could not finance in any other way, that we always stood in a position to take Common Stock for these advances, or for part of them, and the record shows that we did actually ex-

—7,076—

8897

tinguish some of these advances by taking Common Stock for them.

Now, as to the other side of it, where they had financed their own requirements a little ahead of time and had some cash which they did not immediately require in the normal conduct of their business, we did assist them to the extent we could in earning some return on that money, but it was not at all from the point of view of what you might call the commercial banker.

8898

Q. How have the financing requirements of the subsidiaries of the nature formerly taken care of by this system of advances been met since 1935? A. They have been met, very largely, by direct financing by the subsidiaries themselves, and in part, by the use of their own funds representing reserves made out of income and in part, by undistributed earnings, from time to time.

Q. And as to temporary requirements such as I understood were those primarily satisfied by the advances prior to 1935, have those requirements been met, in part, by bank loans made directly by banks to the subsidiaries since the cessation of the practice of advances? A. To a very limited degree,—you are speaking now of short term bank loans, as

distinguished from these long term loans which are shown in the schedules of financing?

Q. Speaking of both. A. There have been some long term

—7,077—

loans, such as the \$15,000,000 bank loan obtained by the Union Electric Company of Missouri, and the bank loan secured by Wisconsin Electric Power Company at the time of its refinancing in 1935, but there has been practically no short term borrowing by any of our subsidiaries.

My recollection is that in only one case, one of the minor subsidiaries, has there been any bank borrowing, and that amounted to a matter of two or three hundred thousand dollars,—I don't recall any other.

8900

Q. How do the rates of interest on long and short term bank borrowings by subsidiaries compare, since 1935, with the rates previously charged by North American Company to subsidiaries for advances? A. The subsidiaries did not begin to make any of these loans until the money market had got to a point where that money could be obtained very cheaply. The \$15,000,000 loan of the Union Company, for example, could be obtained on a per cent. basis, which was better, as an actual interest rate, than the basis on which the company could sell its mortgage bonds at that time, and it also afforded a way by which permanent financing on a long term basis could be done at some time in the future without incurring the expense that would have been involved in calling long term bonds, so that it is not possible to compare the experiences during a period of low money cost

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—7,078—

which prompts that kind of financing, to a certain extent,

8902

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with the experience during a period where the requirements are not permanently financed because money rates are high.

Following the Union loan there have been one or two other loans, long term bank loans placed on even more favorable rates, and the Wisconsin Company, having made one long term loan, was able to readjust the rate of interest on that very loan, at a lower rate later on.

8903

Money rates, at the present time, as you know, are very low and have been for the past three or four years and they have, during that period, for the most part, shown a tendency to get cheaper.

Q. Do you know whether or not the subsidiaries to whom advances were made from time to time by The North American Company, could have at such times, have borrowed such sums to meet their then requirements from commercial banks.

8904

A. At times, I know that the amount of our advances have been in excess of what the companies could possibly have secured from the banks and I think at any time when we were advancing the money it was more to their advantage from the general maintenance of their credit to obtain the money from The North American Company than to obtain it from banks.

Q. Did they obtain it at a higher cost than they would have paid to the banks if they had borrowed from the banks?

—7,079—

A. I am sure they did not. And, in effect, the amount of the borrowings was such that it would to some extent have strained the banking credit of a company. You just can't compare the money rates at all.

Q. But you made no comparison by looking in the record, in that respect, or from your own knowledge? A. I have

already testified that the rates which we were charging the subsidiaries bore a reasonable relationship to the rates which we, ourselves, were paying to the bank. Now, at the time when we were borrowing money from the banks, we had no funded debt at all; that was before the issue of our debentures, and I don't think that the subsidiaries could have borrowed to as good advantage as The North American Company, at that time.

Q. The reasonable relationship you speak of is the relationship shown by the figures heretofore given in the course of cross examination as to the rates paid? A. Yes. 8906

Q. Do you know anything as to any efforts made by the subsidiaries during this period when they received advances from North American Company in the way of attempting to secure money from outside interests, namely, from banks, in lieu of receiving advances from North American? A. No, I have no knowledge of that.

Q. Do you know whether they did, or did not, in general, —7,080— attempt to obtain loans in lieu of advances from the company, that is, loans from outsiders, banks. A. No, I do not. 8907

I do know that in many instances the amount of our advances was in excess of what the banks in the company's territory could have lent them.

Q. Was it, at times, in excess of their immediate needs, the immediate needs of the subsidiaries? A. No.

Q. In other words, you would say it was not the practice of the North American Company, when it had idle funds, to make an advance to a subsidiary for the purpose of using the funds? A. Definitely, no.

8908

Herbert C. Freeman—By Respondents—Cross

Q. The salaries paid to the officers of North American Company are set forth in each case, are they not, in the U-5-S Report filed with this Commission? A. I believe they are.

8909

Q. You spoke of a contract entered into by The North American Company with Thomas A. Edison in 1890, relative to financing certain works of Mr. Edison for a period of five years, in return for which certain uses of his inventions and patents was obtained by North American. Were other companies under North American parties to that contract, too, or did other companies have similar contracts with Mr.

—7,081—

Edison? A. No other companies were parties to our contract with Mr. Edison, to the best of my knowledge, and I have no knowledge as to whether he had similar contracts with other companies.

As to that particular type of contract, I believe not.

8910

Q. The right to use his patents and inventions to the extent granted in The North American Company was not exclusive of The North American Company, was it? A. I don't know. I do know that that was a particular type of contract which related to the application of electric power to railroads, and my understanding is that that was somewhat exclusive to The North American Company.

Mr. Villard, of course, had been quite close to Mr. Edison, and was a great believer in the use of electric power for automotive purposes. He was interested in railroads, and it is my impression that that contract was intended to give The North American Company certain rights which other people could not enjoy with respect to that application of electricity.

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8911

Q. You have given certain figures relative to the percentage, or proportion, of earnings available for Common Stock dividends of the subsidiaries of North American Company, which have been actually taken up by way of dividends.

Now, in respect to those particular companies—

The Presiding Officer: (Interposing) New York is calling Mr. Freeman, so we will suspend for a few minutes.

—7,082—

8912

(Whereupon, following the taking of a short recess, the hearing was resumed.)

By Mr. Binford:

Q. (Continuing) Now, for example, the Union Electric Company of Missouri, can you state what proportion of the earnings of that company available for Common Stock dividends have been actually paid in as Common Stock dividends during the last five years?

Mr. Hamilton: Would counsel clarify that question of dividends? 8913

By Mr. Binford:

Q. Can you state what proportion of the earnings of that company available for Common Stock dividends have been actually paid in as dividends, on Common Stock during the past five years? A. My statement related to a fifteen-year period, and I don't think it is entirely fair to relate a figure of that kind to too short a period, because, after all, one

8914

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accumulates surplus during some years in order that it may be available during other years and during other years it may not be necessary to accumulate surplus. I don't know whether I have got the figures relating to any of these companies for individual periods. I should have to refer to the account of that company to determine what that was.

—7,083—

8915

Q. You are unable to answer the question as phrased, at the present time? A. I am unable to answer the question about the Union Company now, yes.

8916

Q. Speaking generally, but again with reference to Union Electric Company of Missouri, isn't it true that during the past five years practically all of the earnings available for dividends on Common Stock have been paid to The North American Company in actual cash dividends? A. I should have to look at the accounts of the company to answer that. I can only answer it in a general way with respect to the last one or two years. I do know that during the last one or two years a substantial proportion of the earnings of that company have been paid out. You are speaking now of a five-year period and I can not answer it specifically with regard to a five-year period.

Q. Can you answer it with regard to any particular period since 1935,—any shorter period? A. I have already indicated that my recollection is that during the last two or possibly three years a substantial proportion, very nearly all of the earnings have been distributed in the form of cash dividends,—I can't speak further than that.

Q. Now, with respect to the earnings of the Potomac Electric Power Company available for dividends upon Com-

mon Stock at that time, has the larger proportion of those

—7,084—

earnings been paid up to its parent, Washington Railway & Electric Company, since 1935 than would be indicated by your fifteen-year figure? A. I believe the proportion for the last five years would be larger than it was for the entire fifteen-year period.

In that case, however, it has to be kept in mind that we have accumulated very large surplus,—that company has a surplus, at December 31, 1940, of over \$31,000,000, and earnings have been allowed to accumulate in that company, as they have in all our companies, during periods when, for example, The North American Company was paying stock dividends.

8918

The stockholders of The North American Company are entitled to some return on their investment, and during the period when we were paying stock dividends, it was for the specific purpose of providing, in that way, for the requirements of the operating companies, and during that period, we allowed a very large amount to accumulate in the surpluses of those companies.

8919

Now, that cannot continue indefinitely. One accumulates a surplus in order that the earnings of later years may be available for distribution, and certainly with respect to the Potomac Electric Power Company, one of the problems has been that the size of their surplus is so great that it is almost

—7,085—

an embarrassment.

Q. You state that the purpose of the accumulation of surplus is that earnings of later years may be available for

8920

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distribution during such years. Hasn't it always been true that one purpose of leaving a portion of the earnings available for dividends upon Common Stock in operating companies is to provide, in part, for the growth and development of those systems and necessary equity expenditures and investments essential to such growth and development? A. That is one purpose, and I think that purpose has been very fully recognized by The North American Company. The Schedule which was filed as an exhibit yesterday shows that the Common Stock investment, both Common Stock and surplus, in all our companies is very satisfactory.

8921

Q. You would not state that the period of growth or development in respect to the electric utility companies has come to an end, would you? A. By no means, and I think a period of possibly rather intensive growth is beginning, has already begun.

8922

During the period from 1931 until 1936-37, I think the average utility company was able to provide for its requirements out of its reserves, which it made out of current income, provided their reserves were at the rates which The North American Company has provided during that period.

—7,086—

Q. But to the extent that a motive or purpose which you suggested might have actuated the management of The North American Company in leaving a certain proportion of earnings otherwise available for Common Stock dividends in the subsidiary operating companies, that factor still exists, does it not?

The Witness: Will the reporter repeat the question?

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8923

(Whereupon, the pending question was read by the reporter.)

The Witness: Yes, I would say it still exists. It is a factor which fluctuates from time to time. It is of considerable importance during times of large expansions; it is of no importance at all during periods when expansion can be taken care of out of current reserves, and it is of varying importance at other times.

8924

By Mr. Binford:

Q. Isn't it true that since 1935 the proportion of earnings of subsidiary companies of The North American system which have been left with the earning companies, rather than drawn out by way of dividends, have been much less than it has over the fifteen-year period as a whole, which you have heretofore mentioned? A. It has been less,—I don't think it is fair to say that it has been much less.

—7,087—

I could give you a figure for the North American system, as a whole, for the last five-year period.

8925

Q. I would like to have a figure, if you will. A. I cannot give it as to specific companies, and I would like to make this comment in connection with it:

That the percentage which The North American Company has drawn down from its utility subsidiaries during the last five years of the period which I covered was less than the percentage drawn down by the eight independent companies during the preceding five-year period which was a period of some considerable difficulty for utility companies.

8926

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During the five years from 1935 to 1939, for The North American utility subsidiaries, as a group, 85 per cent. of the balance available for dividends on Common Stock was paid to North American Company in the form of dividends or to minority stockholders of those companies that had minority stock holdings outstanding, and they are entitled to some return on that capital, and during the preceding five years from 1930 to 1934, the eight independent companies paid out 87.4 per cent. of their earnings in the form of dividends.

8927. Q. Now, does the figure which you have just given with relation to The North American Company compare with similar figures which you gave yesterday with reference to the taking up of dividends over the fifteen-year period? A. The figure for the fifteen-year period was 69.1 per cent.

—7.088—

Q. During the fifteen-year period,—then the figure which you gave for that period on direct examination is somewhat misleading as to the recent policies of the company, isn't that true? A. No, it shows the long-range policy which has been to build up these companies, and during these past few years, these companies had passed the very severe period from 1930 to 1934 and had got into a period when the depressed conditions were not on them to the same extent, neither had the requirement for additional capital borne down on them to the extent that it is beginning to now, and may, for the next few years.

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So that, this is entirely consistent with our long range policy, and it simply represents the advantage we have had during one period of paying out a larger proportion of earnings because of the fact that we have refrained from paying out so large a proportion during earlier years.

Q. In Exhibit No. 128, which is in ~~in~~ tabular form, and 129, which is in the form of a graph, you have set forth the consolidated earnings available for interest charges and dividends of The North American Company and North American Edison Company from 1930 to 1939, inclusive of both years, together with a picturization in the case of Exhibit 129, of the deviations from the ten-year average in respect to certain named companies.

—7,089—

Now, as to Exhibit No. 129, which is the graph, has there been any weighting of the data shown in respect,—for example, Wisconsin Electric Power Company and subsidiaries, as to the amount of earnings involved as distinguished from the fluctuations of such earnings? A. The weighting of those earnings is reflected in the consolidated earnings available for interest charges and dividends of North American. After all, the North American Company is a weighting of the results of the constituent companies, but from the point of view of the investor, the investor does not go out and buy a weighted range of stocks, he goes and buys 100 shares of one stock and 100 shares of another, or maybe 10 shares of one and 10 shares of another. He is getting the benefit of the weighting, if he buys North American; but if he buys individually, he is just as likely to buy 100 shares of St. Louis County Gas as he is to buy 100 shares of Wisconsin Electric Power, if those stocks are available.

So that, what this study tries to show is that from the point of view of an investor who buys individual companies, or buys stock in several companies, he fares better, on the average, if he is an investor in the securities of North Ameri-

8932

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can Company than if he buys on his own judgment stocks of individual companies which may be available in the market, related, of course, to the stocks of the companies which are owned by North American.

Q. Now, the unbroken red line on Exhibit 129 which

—7,090—

8933

represents, according to the legend, Wisconsin Electric Power Company and subsidiaries, shows an extreme high point in the extreme lefthand corner of the chart, and there are marked deviations from the black line representing the consolidated earnings figure. There is no way, by looking at this chart, is there, by which one can tell what proportion of the consolidated earnings is represented by the earnings from Wisconsin Electric Power Company and subsidiaries?

In other words, by the red line, that might represent either ten cents or a million dollars, or any figure. It merely shows the fluctuations there. A. The chart is merely a graphic representation of the figures on the schedule which is the previous exhibit, and the figures for Wisconsin Electric Power are shown in this schedule.

8934

We could not, of course, express both figures and trends in the one chart.

Q. Washington Railway & Electric Company and subsidiaries, shown by the green line, shows less fluctuation, does it not, than the consolidated figure line? A. Yes. Obviously, the consolidated line represents a combination of figures and it is almost to be expected,—it is to be expected that some of those figures will fluctuate more than the consolidated line, and some will fluctuate less,—that is why the consolidated line is represented, to some extent, as an average.

—7,091—

And, the fact nevertheless remains that an investor who had to choose, in 1930, what stock he would buy, would quite possibly have bought Wisconsin Electric Power and not have fared so well. He might possibly have bought Washington Railway & Electric, and in that case, he would have fared better, but there is another factor that enters into that:

This chart is prepared at the end of the period looking backward. We have to think of the position of an investor at the beginning of this period, looking forward, and he hasn't the power to tell what these figures are going to show over that succeeding ten-year period,—and if he could have gone back to a previous ten-year period to get the figure then, and had looked at that figure and bought the stock which might have been more favorable than another, then the stock he chose might not have been as stable over the next ten years as it had been in the past ten years, but if it had been, the chances are that he would have had to pay a premium for that stability.

8936

Now, he gets that stability as a component part of his investment in North American.

Q. Without the payment of a premium? A. Yes,—he may pay a premium for the North American stock, based on the judgment of investors that a consolidated picture such as North American will tend to be more stable than individual investments in individual companies.

8937

—7,092—

That is quite possible, but, he will not pay a premium for one stock which may not be justified, based on the experience over succeeding years, and he will be spared from some of that,—of the fortunes of individual stocks which he can't prevent.

8938

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Q. Of course, however, I presume that the combination of an investment of erratic earning power with an investment of stable, established and somewhat consistent earning power does not result in any advantages of stability, does it?

The Witness: Read the question back, please.

(Whereupon, the pending question was read by the reporter.)

8939

The Witness: That question can only be answered from the point of view of a given moment of time. Who can say, at this time, what securities are in companies of erratic earning power, and what, in companies of stable earning power, as applied to the next ten years. I am speaking now of utility companies.

By Mr. Binford:

Q. And can anyone say that within the next ten years the erratic nature of the earning power may not be rather accentuated by the combination, rather than decreased by it?

8940

In other words, the behavior of one company in respect to earnings necessarily offsets the behavior of another. Isn't it true that a depression in one may simultaneously occur with a depression in another, in their earning power? A.

—7,093—

One may speak only from past experience in that way, and it may happen that all companies will suffer, as they did in 1932 and 1933. They did not, however, suffer in the same proportion, and the combination of several companies will always give an experience that lies between the extremes of those various companies, and to that extent, stability can be achieved.

You cannot guard, by any combination, against conditions which affect all companies in the same way. You can only do so to the extent of smoothing off the effect of those changes by a combination of several companies.

Q. And as you add the number of companies in your portfolio, you necessarily increase the probability that one of them will be bad in performance? A. I would not say "probability".

Q. Possibility? A. There is always a possibility, no matter how well you pick your company, that it won't do as well as other companies, that something may be wrong.

Q. And that possibility increases in direct proportion as you increase the number of your companies in which your investments are placed? A. No, that would only be the case if the companies were selected haphazardly, but if the companies were selected with reasonable good judgment, with the expectation of their being held over an extended period,

—7,094—

you will have some cases that, in spite of you, will turn out badly, perhaps, but you don't certainly increase your risk in the sense I gathered you implied in your question, just by the number of companies that you hold.

Q. Now, referring again to the chart, Exhibit 129, I notice that the consolidated earnings represented by the black line upon that chart is stated to be Consolidated Earnings Available for Interest Charges and Dividends for The North American Company and North American Edison Company.

Since the figure for interest charges is a fixed figure, and the figure left for payment of dividends is a residual figure,

8944

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I presume that a line showing only consolidated earnings available for dividends, that is to say, after the deduction of interest charges, would show considerably more fluctuations than the black line on the chart, is that true? A. I will have to look at the figure to check on that.

Q. Isn't that necessarily true? A. It depends on how your average works. You are talking of averages, and not specific figures, and I never like to generalize about averages without studying the figure.

8945

I would not want to answer your question without study.

Q. Without studying the figures, isn't it a necessary conclusion that any change is reflected first in the amount of earnings available for dividends before it is reflected,—

—7,095—

rather, it is reflected to a greater extent and greater percentage in the amount available for dividends than it is in the larger amount of fixed charges plus amounts available for dividends? A. Let's look at the figures, they are here.

Before I do that, however, I want to point out one thing and it is an important factor in connection with this presentation:

8946

That we are looking at this thing from the point of view of a cross section of the investors in The North American Company. After all, The North American Company consists of debenture holders, Preferred Stockholders and Common Stockholders and the importance of stability is just as great for the debenture holders as it is for the Common Stockholders. It is greater, in fact, because the Common Stockholder knows that he is taking a more speculative position. Now, beyond that, an investor in the Common Stock of North

American Company would be very limited as to the amount of investment he could make in the stock of these individual companies.

It is only if you take a cross section of the investment, and as you say, the Common Stockholder is a residual investor in a situation of that kind, when considering the debentures and Preferred Stock. The holder of Common Stock, if he wanted to go out and buy the same proportion in the stocks of these individual companies, would have to make an investment representing a cross section not only of his

8948

—7,096—

own Common Stock investment but of the senior capital over that particular investment, so much Preferred and so much for debentures and so on, and unless he does that, his ability to match the investment in the stocks of these subsidiary companies is limited to that extent, and his risk is accordingly increased, because instead of being able to buy the stocks, let us say, of two of those companies, and, in a sense, averaging his risks, he might only be able to invest in the stock of one company and that might happen to be at the beginning of some particular ten-year period where that company was going to run into difficulties.

8949

Now, if you still want me to give the figures as to the results to the stockholder, the Common Stockholder, I will be glad to do that.

Q. If you please. A. The figures that are represented by that heavy black line are the figures described in about the middle of the chart Total Consolidated Earnings Available for Interest Charges and Dividends of The North American Company and North American Edison Company. Now, it was in order to make the steps in this table as simple as pos-

8950

Herbert C. Freeman—By Respondents—Cross

sible that we next arrived at the consolidated balance available for common dividends and surplus, that is, after deducting the interest charge and Preferred dividends of the holding companies. That is in that next line.

—7,097—

8951

Now, as to that, the average deviation during the ten-year period from the ten-year average was 25.68 and that compares with an average deviation for the ten-year period for the eight constituent companies of 26.02. In other words, on that extremely severe test, the experience of the consolidated picture is still somewhat better than the average of the constituent companies.

Now, as to the maximum deviation of that particular line of figures on the plus side, you will see 74.15, which is shown by the figures for the year 1930. The maximum deviation on the plus side of the average of the seven companies is 55.07; also for the year 1930. So that, there is some advantage for the eight constituent companies above the average.

8952

Now, as to the maximum deviation below the average, the maximum for the consolidated figure is 42.13, which is shown by the figure for 1934, and the maximum deviation below the average for the eight constituent companies is 40.80, which is shown also for that year, 1934, so that there is practically no difference.

Q. Now, according to the same table, Exhibit No. 128, the ten-year average deviation of the consolidated available earnings available for interest charges and dividends of The North American Company and North American Edison is

16.54, is that correct? A. Yes, that is for interest charges

—7,098—

and dividends, consolidated.

Q. And that is the deviation reflected in the black line on the chart, 129? A. That is true and the fairest basis of comparison,——

Q. (Interposing) That contrasts, then, with the ten-year average deviation of 25.68 which would be applicable if the consolidated earnings were shown available for dividends as distinguished from the interest charges and dividends? A. Yes, and that is the most unfavorable comparison on this schedule, and yet, it is still better than the average for the eight constituent companies.

8954

Now, we have two other bases of comparison on this same schedule, one is Corporate Balance Available for Common Dividends and Surplus, and the percentage of deviation from the average for ten years is only 17.71, as against 26.02 for the eight constituent companies, and the Corporate Earnings Available for Interest Charges and Dividends shows an average deviation for the ten-year period of 9.63 as against 26.02 for the eight constituent companies.

8955

So that, on any basis of comparison, the consolidated, that is to say, The North American figures, are more favorable than the eight constituent companies, and it just happens that the most unfavorable comparison which represents the maximum risk in the North American situation, that is, of the Common Stockholders, is not much better, but it is better.

—7,099—

Q. I believe you characterized the investment of North American Company in Pacific Gas & Electric Company as

8956

Herbert C. Freeman—By Respondents—Cross

a stabilizing influence upon the income of North American Company, is that true? A. That is true.

Q. And to a lesser degree, you so characterized the investment of North American Company in Detroit Edison?

A. Yes, to a lesser degree.

Q. By which I presume that you meant in the case of each of these companies it includes the income received from the investment therein with the income received from the subsidiary, or other subsidiaries, of The North American Company, resulted in a more consistent and less varying rate of return upon the aggregate of the investment represented. A. It is one of the factors that has made the experience of North American Company, itself, more favorable than the experience of the constituent subsidiaries.

8957

Q. So, if the income received from Pacific Gas & Electric Company by The North American Company has been more consistent and stable than the income received from companies which it admittedly controls— A. (Interposing) We control the companies but we do not control the influences affecting those companies, and it so happens that the Pacific Coast tends to show a lag in changes in business

8958

—7,100—

conditions, and on the whole, it does not seem to suffer as severely or with such a wide degree of variation as the rest of the country.

Q. Would you say the same thing as to Detroit? A. No. I indicated that as to Detroit, the element of stability was substantially less.

Q. But, nevertheless, you characterized that investment as a stabilizing influence? A. Well, to some extent. During

a part of this period the dividends from Detroit have been as high as eight per cent. and they dropped to four per cent.; then they came up to five and six per cent. They are now at six per cent.

Now, obviously, the drop from eight to four per cent. was a rather severe one, and that does somewhat militate against the stabilizing influence at that particular time. It depends upon when you start. If you start at the point where the dividends were four per cent., then the fluctuation you have upward from four to six per cent. may be a little more stable than the fluctuation upward in the case of one or two others of our companies.

8960

Q. The fluctuations downward of Detroit Edison Company came at about the same time as a decrease in earnings on the part of Cleveland Electric Illuminating Company, did it not? A. At substantially the same time, I would say.

Q. The two companies are subject to a great number of —7,101— the same forces, in so far as economic conditions may affect their earnings, are they not? A. To a large extent, they are; they are in somewhat the same industrial territory.

8961

Q. Mr. Freeman, you spoke in some detail yesterday of the widespread distribution of North American Company shares of stock, pointing out that shares were held in every state in the union and other places which you named.

What proportion of those shares are usually represented at a stockholders' meeting of The North American Company? A. That has varied, of course, according to the requirement for a quorum, but where we have needed a two-thirds vote, we have received, I think, as high as, —I believe as high as 76 per cent.

8962

Herbert C. Freeman—By Respondents—Cross

Q. That was in 1939, I think that was the last occasion?

A. 1939, yes. For the annual meeting where we needed only a 50 per cent. vote, I think the average representation has run between, say, 56 and 60 per cent. I am speaking now entirely from memory.

Q. Was that true of 1940? A. The stockholders' meeting in that year, 1940?

I believe we received between 55 and 60 per cent. of each class of stockholders.

8963

Q. You say "received";—you mean proxies representing that amount were given to the management? A. Let me

—7,102—

correct that.

I am speaking now entirely from memory. I believe that in 1940 we received upwards of 60 per cent. of common stock and a lesser proportion of preferred stock.

Q. At the stockholders' meeting in 1940, for example, what number of shares were represented by persons other than proxies elected by the management of North American?

A. A negligible per cent.

8964

Q. Did it amount to 1 per cent.? A. I don't believe it did.

Q. Were you present at that meeting? A. Yes.

Q. How many others were present? A. Well, last year there were about 60 people, I should say.

Q. Who were the officers or persons designated by the management as proxies in the form of proxies sent out to the shareholders in 1940? A. I don't remember that. I believe I was one of the proxies and I think most likely the others were Mr. Shea and Mr. Fogarty, but I am speaking from memory.

Herbert C. Freeman—By Respondents—Redirect

8965

Q. And you gentlemen who were proxies exercised proxy power in accordance with directions from the Board of Directors? A. Yes.

Mr. Binford: I have no further questions to ask Mr. Freeman at this time, but I will reserve the right

—7,103—

to recall him for further cross examination if it appears desirable, before the close of these hearings, although I have no present thought that it will be needed.

8966

Mr. Hamilton: I have a little redirect.

Redirect Examination By Mr. Hamilton:

Q. You were asked a question about percentage of proxies, and so on, at the annual meeting of North American.

Doesn't the company comply with the proxy regulations of the Securities and Exchange Commission? A. It does.

Q. And such matters as directors to be elected, and at certain dates in the past, questions of designation are required, or were required, weren't they, by those rules, to be enclosed in proxy statements submitted in connection with the solicitation? A. That is so.

8967

Q. You were asked a certain number of questions as to the proportion of earnings available for dividends of the subsidiary companies actually paid out during the period 1935 to 1940.

When I said "paid out", I am referring to paid out on the Common Stocks. Was there, during this period 1935 to

8968

Herbert C. Freeman—By Respondents—Redirect

1940, a Federal Statute with respect to the undistributed profits? A. As to the taxes?

—7,104—

Q. Right. A. Undistributed profits were covered by a provision in the Revenue Act during that period.

Q. Was the effect of that statute, roughly speaking, to impose a penalty for failure to declare dividends? A. That was the effect.

8969

Q. You were also asked whether or not The North American Company, as such, was subject to regulation by any State Regulatory Commissions, and I believe you answered that it was not, with a minor caveat as to the New Jersey State Corporation Laws.

In answering the question, were you aware of the existence of certain statutes in various of the states in which subsidiaries of The North American operate relating to so-called affiliate relationships, or affiliate contracts? A. I was aware of the existence of such laws; I did not make any reservation with regard to it in answer to the question.

8970

Q. In the past, certain transactions involving The North American Company, on the one hand, and subsidiaries of The North American on the other hand have been, have they not, the subject of applications to various state regulatory authorities? A. That is so.

—7,105—

Q. And also the subject of approval by those regulatory authorities? A. Yes.

Q. You were also asked as to the dates on which Mr. Shea became President of The North American Company.

Herbert C. Freeman—By Respondents—Redirect

8971

Did he, prior to election as President of The North American Company, serve as a director of that company? A. He did, he had been a director since, I believe, November, 1938, and had been a member of the Executive Committee. He became President in December, 1939, I believe.

Q. In discussing the personnel of The North American Company in response to specific questions, you used the term, I believe, "non-executive secretaries". Simply for the purpose of clarification, will you state whether or not that term comprehended secretaries to executives? A. That is another way of expressing it.

8972

Q. You were also asked which of the present officers of The North American Company have had engineering training.

Is it necessary, Mr. Freeman, to have a degree of Bachelor of Science in Engineering from M. I. T. in order to be able to understand or consult with operating problems of utility subsidiaries of The North American Company? A. From the point of view of operations, I would say definitely not.

Q. There are some questions of business judgment, are —7,106—

8973

there not, in the operations of these companies? A. Most of the operations involve the exercise of business judgment.

Q. When you have devoted your life to the business of the conduct of these properties, that is, your business life, in the course of time do you get a certain familiarity with its operations?

Mr. Binford: Objected to on the grounds that it has not been shown that Mr. Freeman has devoted his life to operating problems.

Mr. Hamilton: I will qualify that.

8974

*Herbert C. Freeman—By Respondents—Redirect**By Mr. Hamilton:*

Q. During the period of fourteen years of service with The North American Company, Mr. Freeman, haven't you necessarily acquired a certain familiarity with these problems? A. I have, to a very great extent, and I have brought to them, I think, an experience gained during the previous twenty-five years.

8975

Q. You have testified as to the length of service of certain of the other officers of North American Company, namely, Mr. Fogarty. Will you state again, how long he has been connected with The North American Company? A. Mr. Fogarty has been connected with The North American Company for thirty-eight or thirty-nine years.

Q. As a matter of fact, do you happen to know whether

—7,107—

his first job was with The North American Company? A. Yes, he has told me that.

8976

Q. From your knowledge of Mr. Fogarty's service, are you able to state whether that length of service on behalf of The North American Company has equipped him to discuss these problems of these various subsidiaries? A. Unquestionably I should say that there are very few men better equipped to discuss any of the problems of the subsidiaries.

Q. Have you stated the length of time during which Mr. Piske has been connected with The North American Company? A. Yes, Mr. Piske, I believe, has been connected with The North American Company for twenty-nine years.

Q. Do you know whether or not Mr. Piske similarly started out his business career in The North American Company? A. I believe he had some experience before that.

Herbert C. Freeman—By Respondents—Redirect

8977

Q. On the basis of your knowledge of Mr. Piske, would your answer as to his capacity to discuss problems with subsidiaries,—would it be the same as your answer in relation to Mr. Fogarty's qualifications? A. It would differ only as to degree. I think Mr. Fogarty's experience has been broader and it has been longer.

Q. Have you stated how long Mr. Sealy, formerly the Treasurer of North American, had been connected with The North American Company? A. He had been connected with

—7,108— 8978

The North American Company for thirty-five years at the time of his retirement at the end of last year.

Q. At the earlier stages of Mr. Sealy's career, had he been connected with subsidiaries of The North American Company? A. He had been connected with the Wisconsin group of companies, also with the West Kentucky Coal Company.

Q. And similarly, as to Mr. Sealy, on the basis of your knowledge as to his ability, would your answer generally be the same as you have previously given for Mr. Fogarty and Mr. Piske? A. Yes.

8979

Q. Do you regard at least certain of the executives of the operating subsidiaries as being successful operators from the standpoint of results achieved and from the standpoint of the services rendered by their respective companies by which they are engaged? A. I believe The North American subsidiaries are operated by as fine a group of men as will be found in the industry.

Q. Now, are you speaking as to personalities, Mr. Freeman, or as to results? A. As to ability and results accomplished.

8980

Herbert C. Freeman—By Respondents—Redirect

Q. Are all those you have mentioned persons of engineering training? A. No, not all of them.

—7,109—

Q. Can you mention a few who are not? A. As to Presidents of operating companies,—Mr. Crawford, in Cleveland, has not had any technical engineering training.

Q. Notwithstanding that, do you think that he runs his business pretty well? A. I am sure he does.

8981

Another example, Mr. Neal, the President of the Potomac Electric Power Company; he also has not had technical engineering training.

Q. Mr. Doolittle is a director of The North American Company, isn't he? A. Yes.

Q. Has he had engineering training? A. Yes.

Q. Mr. Way is a director of The North American Company, is he? A. Yes, sir.

Q. This is the same Mr. Way who was also President of the so-called Wisconsin-Michigan group of companies? A. That is so; he has been a director of North American Company for several years.

8982

Q. He has had engineering training, has he not? A. He is very highly regarded as an engineer.

Q. Mr. Moody is a director of The North American Com-

—7,110—

pany, isn't he? A. Yes.

Q. Has he similarly had engineering training? A. Yes.

Q. And is Dr. McClellan a member of the Board of Directors of North American Company? A. Yes.

Q. And he similarly had engineering training? A. Yes.

Q. Counsel asked you certain questions as to payments of dividends by Union Electric Company of Missouri since

Herbert C. Freeman—By Respondents—Recross

8983

1935 and also with respect to Potomac Electric Power Company since 1935. He did not refer, however, to the ~~and~~ Milwaukee Electric Railway & Light Company.

What dividends were paid by it on its Common Stock in 1935. A. There was no dividend on the Common Stock of that company in 1935.

Q. And in 1936 similarly? A. Similarly, no dividend.

Q. And in 1937. A. There was no dividend that year.

Q. And in 1938? A. I don't believe there was a dividend in that year. I believe the resumption of dividends in the

8984

—7,111—

case of that company was in 1939.

Mr. Hamilton: That is all of Mr. Freeman.

Mr. Binford: I would like to ask one or two more questions in response to Mr. Hamilton's questions.

Recross Examination by Mr. Binford:

Q. You have named several of the directors of The North American Company and have spoken of their engineering experience.

8985

How many directors has The North American Company?

A. Twelve.

Q. How many of those directors are salaried officers or employees of subsidiary companies of the North American system? A. Four.

Q. Is there a "Executive and Finance Committee of the Board of Directors of North American Company? A. Yes.

Q. Who are the members of that Committee? A. Mr. Fogarty is Chairman, Mr. Harrison Williams, Mr. Shea, Mr. Murnane, and I are the other members of the Committee.

8986

Herbert C. Freeman—By Respondents—Recross

Q. Does that Committee meet frequently. A. Fairly frequently; we meet whenever the necessity arises and we meet regularly, I would say, about once a month.

—7,112—

Q. How often does the Board of Directors meet? A. That varies; they meet, let me put it this way: The intention is that they should meet every month. Occasionally we miss a month if there is no occasion to call these busy men from out of town into New York.

8987

Q. Is the normal and usual procedure for the Executive and Finance Committee to prepare an agenda or formulate proposals to be acted upon by the Board of Directors? A. There is no broad practice of that kind, in the sense of your question. There are matters which are taken up by the Executive Committee, and then are placed on the agenda for the Directors' meeting following it, but not all of the matters that come up at the Directors' meeting are first passed upon by the Executive meeting.

In other words, there is an entirely distinct agenda for the Directors' meeting.

8988

Q. Would you say that the major portion of the business transacted by the Board of Directors is first brought to the attention of the Board of Directors by the Executive Committee? A. No, I don't think that is the case.

Mr. Binford: I have no further questions, at this time, subject to the usual reservations.

Mr. Hamilton: I object, Mr. Examiner to the reservations.

—7,113—

The Examiner: The record will show these reservations and I will refrain from making a ruling until the controversy gets more acute.

Mr. Browning: I will call Mr. Myers.

Daniel Myers—By Respondents—Direct

8989

Whereupon, DANIEL W. MYERS, a witness produced on behalf of the Respondents, having been first duly sworn, was examined and testified as follows:

Direct Examination by Mr. Browning:

Please give your name? A. Daniel W. Myers, of Cleveland, Ohio.

Q. What is your business? A. Investment banking.

Q. Are you a partner in Hayden, Miller & Company? A. Yes.

8990

Q. What is Hayden, Miller & Company? A. It is a partnership.

Q. Is it an investment banking house in Cleveland? A. Surely.

Q. How long have you been in the security business in Cleveland? A. Since 1899.

Q. What was your first connection in it? A. Ambrech Brothers & Company, which I left in 1906 to go with Hayden,
—7,114—

Miller & Company, becoming a partner in Hayden, Miller & Company about 1911.

8991

Q. You have been a partner in Hayden, Miller & Company since 1911? A. Yes.

Q. What is the position of Hayden, Miller in the securities distributing business in Cleveland? A. I think, over the years, and today, we are the principal investment distributing house in Cleveland.

Q. As a member of that firm, and in view of your security business experience, are you acquainted with the Cleveland security market? A. That is all I know,—is marketing, how

8992

Daniel Myers—By Respondents—Direct

much can you sell, and at what price,—that is all I have done for the last forty-two years.

Q. Mr. Myers, did your firm have participation in the issue by the Cleveland Electric Illuminating Company in 1935 of \$40,000,000 First Mortgage 3¾ per cent. bonds? A. Yes.

Q. Will you tell us to what extent? A. \$600,000 in the underwriting, \$400,000 in the firm bonds, in the selling group position.

8993

Q. In the \$50,000,000 issue of the Illuminating Company in 1940, did your firm have any participation? A. Yes, —7,115—

\$500,000.

Q. How did the bonds of the 1935 issue go in Cleveland? A. My recollection is that to the extent of our \$400,000 participation, they sold well.

Q. What about the 1940 issue? A. We had the distinct impression that the bonds were over-priced at 105½.

8994

Q. Did you get all the bonds you wanted? A. Yes. As it turned out, I think we had about \$150,000 more than we needed to have to meet the demand of our market.

Q. How many security houses are there in Cleveland, Mr. Myers? A. Principal houses, I should say about eight.

Q. Is your firm the largest? A. In personnel, no. I would like to say that we are the best and with respect to high grade bonds such as you have referred to, I think we are the largest distributor in the Cleveland market.

Q. Now, Mr. Crawford has already testified here that the total of the 1940 issue which was placed through Cleveland

Daniel Myers—By Respondents—Direct

8995

houses was \$2,500,000, which would include the \$500,000 sold through your firm.

Were your sales all made in the service area of the Illumi-

—7,116—

nating Company. A. No, I can't tell you exactly, but our territory,—we cover northern Ohio, hit the high spots in Cincinnati, and a little territory in western Pennsylvania, and so I can't tell you just how many went into there.

Q. But a part of your \$500,000 bonds went well beyond the confines of the Cleveland area? A. Yes.

8996

Q. Could you have sold the latter amount in the Illuminating Company's service area? A. No.

Q. Could you handle a \$10,000,000 issue of Illuminating bonds? What would be the limit? A. As I understand your question, you are asking me how much the Cleveland market could take if it had the combined distributing power of all the Cleveland houses, the eight principal dealers and all of the small dealers, and with respect to the average bond issue, which has a favorable market aspect, that is, local color in our market, the limit is about two and a half million dollars.

8997

Q. That is, if I understand you correctly, assuming a good market, the maximum amount which all of the Cleveland dealers could sell would be about two and a half million dollars? A. In this kind of a bond.

—7,117—

Q. That is right. Now, is the limit due to any element in the reputation of Cleveland Electric Illuminating Company in Cleveland? A. No, I don't think so; it is rather to the amount of purely investment funds in the Cleveland market.

Q. What is the reputation of Cleveland Illuminating Company in Cleveland? A. I should say,—excellent.

8998

Daniel Myers—By Respondents—Direct

Q. Turning to Preferred Stock, Mr. Myers, the testimony in this case shows that the Illuminating Company sold Preferred Stock in 1920 and 1921 in Cleveland,—did your firm sell any part of that Preferred Stock? A. The eight per cent. Preferred, yes.

Q. Could you tell us how much your firm sold? A. In the period from September, 1920, to November 30, 1920, we sold 5,500 shares.

Q. What was the maximum commitment? A. 2,500 shares; the rest of it was taken down as we sold it.

Q. So that you never assumed a commitment, even for the 5,500 shares total. A. No.

Q. You took stock down and sold it on a retail basis. A.

—7,118—

Yes.

Q. What was the situation with respect to the 6 per cent. Preferred which was sold from 1923 to 1925? A. No Cleveland house made any commitment in that 6 per cent. issue. We were offering it on a selling agency basis at what looks now like a rather handsome commission.

Q. Do you recall what that commission was? A. It says here (referring to document) "3 per cent.", that is, without commitment,—that is pretty good pay.

The Examiner: We will suspend for a moment.

(Whereupon, following the taking of a short recess, the hearing was resumed.)

—7,119—

Q. What amount of preferred stock of the Illuminating Company could the Cleveland market absorb today, Mr. Myers? A. About five million on the single offers.

Q. On that again you are speaking of all of the Cleveland market? A. I am speaking, rather, of the whole Ohio market rather than the Cleveland market. You understand the distinction between, say, the two and a half million limit under favorable market aspects in the bonds yielding the lower return and the higher absorptive capacity of our market in the preferred stocks, which is characteristic of a rather newly developed and non-discriminating market.

Q. Mr. Myers, the testimony in this case shows that the North American Company owns 1,847,908 shares of the common stock of the Illuminating Company. Can you place that stock in the service area of the Cleveland Electric Illuminating Company? A. Not anything like 1,847,000 shares.

9002

Q. What amount of that common stock do you think you could place? A. Do you mean today or under normal market conditions?

Q. Under the market conditions which you have had for some time and which you expect to have for some time. A. If you were talking about today, it might be 15,000 shares. If you were talking about more normal market conditions, my

—7,120— 9003

estimate of the absorptive power of the Cleveland market within a 30-day period would be somewhere around 75,000 shares.

Q. When you say "Cleveland market," there again are you including all of Ohio? A. Yes.

Q. Are the securities of a public utility the type of investment for which a broad market exists in Cleveland? A. No. But there again it is simply that we haven't the broad market for any high-grade security yielding the minimum return.

3004

Daniel Myers—By Respondents—Direct

Q. Is there any difference in that respect between Cleveland on the one side and such cities as Boston and New York on the other? A. Oh, distinctly so. It all goes back to the development of a real investment demand in a rapidly developing industrial territory, where long after I came into the business, all of the men of large wealth in Cleveland were actively engaged in business, and still are to a large degree. You don't get the strictly investment demand until the money gets into the hands of a second or third or fourth generation.

9005

The businessman, in other words, who sees himself making a large return in his own activities does not quite understand that when he invests money he is going to get a minimum return over a long period of years. So that the pity of it is that at the present time our real investment

—7,121—

market is largely limited to endowments and trust funds with, of course, a distribution to domiciled banks and in a degree to the one savings bank that we have in Cleveland.

9006

Now, I could not guess at what the relation would be between this investment money and the total wealth of Cleveland; but in comparison with Boston, where you have the accumulations building up over the years, the amount available there for the purchase of bonds of this sort might easily be ten times over the demand that we have in Cleveland.

Perhaps I could put it this way: If you could imagine—and it is only guesswork—that, we will say, 10 per cent. of the Cleveland wealth—of course, that is exaggerating—was available for investment in bonds of this kind, in Boston it might easily be over 50 per cent. They have not there, of course, anything like the rapidly growing investment develop-

ment which we have had for the last forty years in Cleveland, which has afforded the preferred opportunities for men of money in the Cleveland market.

Q. Do you see any likelihood of any immediate change in the present situation with respect to the limited market in Cleveland for public utility securities? A. In the immediate future?

Q. Yes. A. No. Over the years there would be a tendency to increase the amount available for investment.

—7,122—

9008

Q. Mr. Crawford testified that the Illuminating Company's construction budget is running at the rate of about ten million dollars each year, so that the company may need to have five or ten million dollars of new money each year. In your opinion can the Cleveland market supply that amount of new money to this Cleveland Electric Illuminating Company? A. No possibility.

Mr. Browning: That is all.

Mr. Binford: I have no questions. I make the same reservation as heretofore made in respect to other witnesses.

9009

(Witness excused.)

Whereupon, DUNCAN R. LINSLEY, called as a witness on behalf of the Respondents, after being first duly sworn, was examined and testified as follows:

Direct Examination by Mr. Hamilton:

Q. State your full name and address. A. Duncan R. Linsley, New York City.

9010

Duncan R. Linsley—By Respondents—Direct

Q. Are you associated with the First Boston Corporation?

A. I am.

Q. In what capacity? A. I am a vice president, director, and member of the executive committee.

—7,123—

9011

Q. Will you state your business experience? A. I graduated from the Massachusetts Institute of Technology with the degree of Bachelor of Science in 1922, and in the fall of that year entered the employ of Harris Forbes & Company, becoming a member of the corporate buying department in the spring of 1923.

Harris Forbes & Company, and its earlier predecessor, N. W. Harris & Company, had for a great many years been prominently identified with the financing of public utility companies. I think as a matter of fact they were the earliest house to finance such utility companies.

I remained with that organization, becoming a director in 1929; and when the Chase Forbes Corporation was formed in 1931, became a vice president of that corporation.

9012

Q. When the First Boston Corporation took its present form in June 1934, I became a vice president and director of that corporation, and have been with them ever since.

Q. What does the First Boston Corporation do? A. The First Boston Corporation is a publicly held investment banking firm. Its business may be divided roughly into two categories: First, a day-to-day trading business in United States Government securities and in municipal and state obligations, and in corporate bonds, such as public utilities, industrials, and railroad; and in Canadian securities; and,

Duncan R. Linsley—By Respondents—Direct

9013

second, in the underwriting of new issues of such securities

—7,124—

and their distribution to the public.

Q. Do you have branch offices at various points throughout the country? A. We do. We have major offices in New York, Boston, Chicago, Philadelphia, and in ten other cities in the United States.

Q. Will you give us some idea of the extent of the underwriting business which the First Boston does? A. I think probably it is a safe statement to say that because of the training and experience of some of the members of our organization we have tended more to the financing of public utility companies in issues that are registered with the Securities and Exchange Commission than any other party.

9014

An indication as to the size of our business is given in the Securities and Exchange Commission's Release No. 536, which shows that during 1940 the First Boston Corporation led other firms in the country in the amount of underwriting participations for issues originating under the Securities Act, the amount of our participations aggregating approximately \$97,000,000 or about \$25,000,000 in excess of the next nearest firm.

9015

An examination of the release also shows that the First Boston Corporation ranked first in managing the greatest amount of new issues, with approximately \$237,000,000 or \$30,000,000 in excess of the amount managed by the next leading firm.

—7,124a—

Q. Will you give us some idea as to the extent of public utilities issues in which the First Boston has headed or par-

9016

Duncan R. Linsley—By Respondents—Direct

ticipated? A. Under date of February 5, 1941, the Securities and Exchange Commission published a report covering the issuance during the 6-year period beginning with 1935 and ending with 1940 of all securities of electric and gas utilities of which the Commission has a record under either the Securities Act of 1933 or the Public Utilities Holding Company Act of 1935. An analysis of this report for the 6-year period shows that the aggregate participations of the First Boston Corporation during such 6-year period amounted to something over \$500,000,000 of electric and gas utility securities, which I believe was in excess of any other house in the country; and our firm participated in 205 of these issues.

9017

We headed 69, appeared second in 51, and third in 25 of such issues.

Q. Will you illustrate the issues of particular public utility companies which the First Boston has headed? A. We have headed the financing for more than forty companies scattered throughout the United States.

9018

Q. That is since what date? A. Since the Securities Act has been in effect. Some of the more important would include the Boston Edison Company, The Narragansett Electric Company of Providence, the Rochester Gas & Electric Corporation, the Duquesne Light Company, the West Penn

—7,125—

Power Company, Pennsylvania Power & Light Company, —the latter two were joint managements with other houses—the Washington Gas Light Company, Toledo Edison Company, Indiana and Michigan Electric Company, Wisconsin Public Service Corporation, Wisconsin-Michigan Power Company, Wisconsin Gas & Electric Company,

Duncan R. Linsley—By Respondents—Direct

9019

Kansas Power & Light Company, Iowa Power & Light Company, Missouri Power & Light Company, and the Southern California Edison Company.

Q. Now, in your capacity as executive of the First Boston have you personally assumed primary responsibility in behalf of that company in the negotiations in a number of these transactions to which you have referred? A. I have. But the duties of a director and member of the executive committee, of course, includes passing on all commitments which the firm takes; and in addition, in connection with the origination and the purchase of utility securities I have had the primary responsibility in quite a few of these issues.

9020

Q. As to what issues of subsidiaries of the North American Company have you had primary responsibility on behalf of the First Boston Corporation? A. Practically all in which the First Boston Corporation headed the financing.

Q. And those you have already stated, have you not? A. I believe they are included in the list which I mentioned.

—7,126—

Q. In addition to these instances in which the First Boston has headed the particular financing, have there been other issues of North American subsidiaries in which the First Boston has had a participation? A. There have.

9021

Q. Will you illustrate just a few? A. I believe it is a safe statement to make that we have been a major underwriting company in practically all of the issues of subsidiaries of the North American Company with the exception of the Potomac Electric Power Company; and in quite a few of those issues we have had second position.

9022

Duncan R. Linsley—By Respondents—Direct

Q. In addition has the First Boston had participation in the security issues of the North American Company itself?

A. We have.

Q. Both as to the debentures and the preferred stock?

A. Yes, sir.

Q. And also as to the common stock distribution in 1938?

A. Yes, sir.

9023

Q. Based on your experience in connection with the financing transactions of the North American Company and subsidiaries, to which you referred, are you able to express any opinion as to the savings or economies which those subsidiaries have obtained in their financing operations by reason of being subsidiaries of the North American Company?

A. I have.

—7,127—

Q. You are able to express such an opinion? A. I am.

9024

Q. Will you do so? A. My experience in connection with, let us say two issues that I followed closely on behalf of my firm, namely, the Kansas Power and Light Company and the Missouri Power and Light Company—as a result of my experience with them I am of the opinion that there were decided savings to those companies because of their being affiliated with the North American Company and having the benefit of the experience of the executives of that organization.

Q. You spoke of issues of the Kansas Power and Light Company. Will you give us a little more facts in that regard? A. Prior to 1935 the two major properties which are now a part of the Kansas Power and Light Company, namely, Kansas Power and Light Company and the United

Duncan R. Lindsay—By Respondents—Direct

9025

Power and Light Corporation of Kansas, were not at all well known from a credit point of view, and their securities were not held by the more informed buyers.

Kansas Power and Light Company had its origination as a means of financing the old Tecumseh plant. It was purely a generating company, and in time gradually broadened the type of its business to include the distribution of electrical energy as well as generation, and also got into the gas business.

—7,128—

The United Power and Light Corporation of Kansas—I remember in the middle 20's several issues of bonds for that company which the old Harris organization handled, which took three to four weeks before they were disposed of. It was a question of going out and finding buyers and educating them on what the company was.

9026

In 1935 there were five companies, I believe, put together through a merger or consolidation to form the present Kansas Power and Light Company, which included the United Power and Light Company of Kansas; and at the time there were eight separate bond issues on the constituent companies bearing coupon rates of 5 and 6 per cent., aggregating approximately \$25,000,000 principal amount.

9027

An analysis of the institutional holdings of the bonds of the Kansas Power and Light and United Power and Light, two of the major constituent companies in the consolidation, as taken from Poor's Insurance Company Holdings as of the end of 1934, that is, as of December 31, 1934, which was published in their edition of 1935, shows that only slightly over \$2,000,000 of the obligations of those two companies were held in institutional hands throughout the country. That includes in addition to the life insurance companies, of

9028

Duncan R. Linsley—By Respondents—Direct

course, fire, casualty companies and various funds of societies of one kind or another.

As I have indicated, the credit was unknown.

—7,129—

Under North American supervision a plan was worked out for the consolidation of these properties and the creation of \$30,000,000 of first mortgage bonds, first mortgage 4½ per cent. bonds, which were sold at the end of 1935 at a price of 103 to the public.

9029

That sale was effectuated only after considerable work on the part of our organization in talking, prior to the distribution, with a great many institutions in various sections of the country. I personally, for example, made trips to places like New England, Hartford, various institutions in and around New York City, Philadelphia, Milwaukee, getting what we called the build-up for introducing that credit to the public.

And I may say that one of the important factors and one of the things that was very helpful in arriving at the successful sale of those issues was the fact that the Kansas Power and Light Company was controlled in the North American system, and the assurance of that management meant a great deal to the frame of mind in which the buyers approached the issues.

9030

Q. Did the fact that Kansas Power and Light Company was a subsidiary of the North American Company in your opinion improve the credit position of its securities offered in 1939? A. It did. In 1939 a plan was devised for the refunding of the 4½ per cent. bonds through a new issue of \$26,500,000 of first mortgage 3½ per cent. bonds.

—7,130—

Duncan R. Linsley—By Respondents—Direct

9031

Those bonds were sold to the public at a price of 108½, which was the highest premium that any public utility offered security had been sold at with the exception of two very small issues. One, as I recall it, was Newport Electric, which was about \$300,000 principal amount; and the other was the Madison Gas & Electric, which was done as a private deal, and which, as I recall, was about one million dollars.

That was the highest offered price of any issue on record up to that time.

9032

I am convinced in my own mind that while, of course, I think the First Boston Corporation had a lot to do with it, I think that the fact that the Kansas Power and Light Company was a part of the North American Company system did help materially in achieving the results that we were able to—the aid of that plus good salesmanship on our part.

Q. Did the same practice exist in connection with the preferred stock financing in 1940? A. Yes.

Q. Would your opinion be the same with respect to that financing? A. It would.

Of course, in the case of the preferred stock financing the bulk of it involved an offer of the new 4½ per cent. preferred stock to the existing stockholders of the Kansas

9033

—7,131—

Power and Light Company.

Incidentally, the price of the preferred stock of 103 was exactly the same dollar price that the first mortgage bonds were sold at in 1935, which shows, in addition to probably some improvement in the market, the long way the Kansas Power and Light Company had gone in establishing its credit generally throughout the country.

9034

•Duncan R. Linsley—By Respondents—Direct

Q. What is the present market price of that preferred stock? A. The preferred stock at the present time is quoted at about 102½. Approximately thirty days ago it was quoted as high as 106 bid.

Q. Is that the first Kansas public utility sale of 4½ per cent. preferred stock? A. It is the only one.

Q. Have there been other preferred stock issues of other Kansas Public utilities in this year? A. There have.

9035

Q. By what company or companies? A. There was a recent issue of the Kansas Electric Power Company of 5 per cent. preferred.

Q. You also referred to the financing transactions involving securities of the Missouri Power and Light Company. Did the fact that the Missouri Power and Light Company was at the time of those transactions a subsidiary of the North American Company improve its credit position? A. It did.

—7132—

9036

In the case of the Missouri Light and Power Company, that company likewise was virtually an unknown credit prior to the time the deal was done in December, 1936, which involved the sale of \$9,000,000 of first mortgage 3¾ per cent. bonds and 15,000 shares of 6-dollar preferred stock.

The Poor's 1936 edition of the Insurance Company Holdings as at the end of 1935 shows that about \$1,800,000 of bonds to be redeemed were held in so-called institutional hands.

Following the practice of introducing the credit, I again personally made these trips to talk to institutions. Other members of our organization also talked with a great many of them; and I can recall distinctly that the opinion was ex-

pressed to me by one or two of the buyers that they would not consider purchasing these bonds at the premium of 102 were it not for the fact that the Missouri Power and Light was a part of the North American system; and it was that factor really that in the last analysis was to a large degree responsible for the investment of certain funds in that company.

Q. Is the element of geographical diversification in the North American system an element of value to the North American Company's securities? A. In my opinion it is.

9038

During the middle 20's the North American Company

—7,133—

securities were highly regarded by the investment public generally; and the combination of the conservatism of their policies, together with the geographical distribution of the properties which led to the belief that there would be a stability of income, made the North American securities very popular with the investing public; and relatively that popularity still exists today.

Q. Does absence of diversification in the case of securities of other holding companies constitute a source of weakness? A. I think it does, in my opinion.

9039

Q. Will you illustrate? A. I think one example, without reflecting in any way on the company, is the case of the Standard Gas & Electric Company debentures, 6 per cent. debentures, which for a period of some time sold in a range between 75 and 80 per cent. of par. They have been a little higher more recently.

I am of the opinion that the fact that the Standard Gas derives nearly 50 per cent. of its income from the common

9040

Duncan R. Linsley—By Respondents—Direct

stock dividends of the Philadelphia Company, operating in and around Pittsburgh, has contributed to the discount at which those debentures sell, on the fear that if Standard Gas for one reason or another would be deprived of that income or there was a substantial reduction in it, the margin available to cover the fixed charges would be drastically reduced.

—7,134—

9041

I don't remember the figures exactly, but I believe that the cash income of the Standard is approximately \$6,000,000, and that the interest charges are approximately $4\frac{1}{2}$ million dollars. So that the elimination of the dividend income from the Philadelphia Company would, of course, have a very serious effect; and I am of the opinion that that fear is reflected in the flotation for those securities.

Q. Has First Boston in recent years headed the underwriting group in connection with the offerings of public utility common stocks? A. We have, either alone or jointly.

9042

Q. Will you mention a few? A. We headed the underwriting group which offered the Washington Gas Light common stock to the public. We were joint manager in the distribution of 160,000 shares of the West Penn Power common stock, and a joint manager in the issuance to the public of approximately 714,000 shares of the Indianapolis Power and Light Company common stock, a major portion of which was distributed as portfolio assets, I believe you would call it.

Q. Have you any data in those instances to indicate the extent to which these common stocks were placed originally in the States in which these utilities operated? A. I have.

—7,135—

Duncan R. Linsley--By Respondents--Direct

9043

I might add that it has been a practice of our organization upon the completion of a piece of financing to send out a questionnaire, not only to the members of the underwriting group, but also to the selling members, asking them for their retail distribution by States. We have kept records to show where the securities have eventually found their resting place on the original or final distribution.

In the case of Indianapolis Power and Light Company, which involved a dollar offering of approximately \$16,000,000, there were 93 underwriters in the business. There were 761 dealers throughout the country invited into the selling group, and there were about 470 additional dealers that actually took down stock for sale. So that there was a total of close to 1,300 investment firms which participated in the offer.

9044

Q. In that connection, if I may interrupt: In forming the underwriting group and also the selling group, was any effort made to insure participation by Indiana dealers? A. There was. It was the urgent request of the management of the company that practically all of the responsible houses in Indiana be included in the business as underwriters, and that as much stock be placed in the State as could be sold, without, of course, damaging the success of the deal. Obviously, you cannot burden one State with too much stock and have it sold back on other markets or else it ruins your distribution. But every effort was made to comply with that

9045

—7,136—

request.

The average sale in this operation was approximately 90 shares of stock, and the records show that the retail distri-

9046

Duncan R. Linsley—By Respondents—Direct

bution in the more important states was approximately as follows, expressed in percentages:

In New York State 24.4 per cent.,

In Illinois 15.6 per cent.,

Indiana, 11.7 per cent., or approximately 90,000 shares in Indiana—

Q. That is, for the entire State? A. That is correct, or something over \$2,000,000 of the dollar amount of stock.

9047

Massachusetts 10.6 per cent., Pennsylvania 5.4 per cent., California 4.3 per cent., and so on down.

Q. What happened in the case of the Washington Gas Light offering? A. In the case of the Washington Gas light, we undertook in August of 1934 to sell 362,000 shares principal amount. There were 35 underwriters. There were 695 dealers invited into the selling group, of which 251 accepted the invitation and 444 politely declined.

9048

Around 300,000 shares were distributed at that time and in January the remaining 60,000 shares were underwritten by 33 underwriters with approximately 240 dealers invited into the business.

—7,137—

The record of distribution of those two obligations shows the distribution as follows: New York 24.2 per cent., District of Columbia 21.6 per cent., or approximately 80,000 shares of stock; Massachusetts 10.9 per cent.; California 6.1 per cent.; Illinois 4.5 per cent.; Connecticut 4.4 per cent.; Maryland 4.4 per cent.; Pennsylvania 4.0 per cent.

In this case, as in the case of the Indianapolis Power & Light Company, the management requested that every consideration be given to local houses; and I believe it is a

Duncan R. Linsley—By Respondents—Direct

9049

fair statement to say that the dealers in and around Washington had every opportunity to sell as much of that stock as the market would take.

Q. Now, in the transactions involving the bond issues by North American subsidiaries, have you any data to show the extent of placing the bonds in the States in which those companies operated? A. I have.

Q. Will you give us the facts? A. These percentages refer to the retail sales by both underwriters and selling group members. In the \$30,000,000 issue of first mortgage 4½ per cent. bonds of the Kansas Power and Light Company there were 13 underwriters and 480 dealers invited into the selling group, of which 476 accepted.

9050

Q. Did those include all responsible Kansas houses? A. They did.

—7,138—

Our records show that the distribution by States was approximately as follows: New York 43.8 per cent., Massachusetts 10 per cent., Illinois 8.4 per cent., Pennsylvania 7 per cent., New Jersey 3½ per cent., Wisconsin 3.2 per cent., California 2.9 per cent., Connecticut 2 per cent.

9051

Those constituted 81 per cent. of the distribution.

It shows that \$121,000 of the principal amount of the bonds were sold in the State of Kansas, or .4 per cent., less than one-half of one per cent.

Q. Were the Kansas underwriters or dealers allocated in this case all the bonds that they could take? A. All the bonds that they asked for. Yes.

In the deal of July, 1939, which involved the sale of \$26,500,000 first mortgage 3½ per cent. bonds of the Kansas

9052

Duncan R. Linsley—By Respondents—Direct

Power and Light Company, there were 36 underwriters, and 441 selling group members.

The distribution figures show that retail sales were: New York State 33 per cent., Massachusetts 7.2 per cent., Illinois 6.4 per cent., Pennsylvania 7.9 per cent., New Jersey 7 per cent., Wisconsin 6.3 per cent., California 3 per cent., Connecticut 6½ per cent., constituting in those States approximately 78 per cent. of the distribution. \$175,000 principal amount of bonds were retailed in the State of Kansas or approximately six-tenths of one per cent.

9053

Q. Was the same policy pursued with respect to attempts

—7,139—

to get local participation and local placement of the bonds?

A. We attempted to follow that policy in Kansas.

Of course, you understand that in the last-named deal the bonds were approximately on a 3 per cent. basis. There just was not a demand in that State for that very low interest rate for a 30-year period.

9054

Q. Now, can you give us briefly the comparable data as to the financing transactions of the Missouri Power and Electric and Wisconsin Gas and Electric and Wisconsin-Michigan? A. In the \$9,000,000 of Missouri Power and Light first mortgage issue there were 12 underwriters and 48 members of the selling group. The retail distribution shows New York State 28 per cent., Massachusetts 10.6 per cent., Illinois 8.7 per cent., Missouri 8.3 per cent., Wisconsin 5 per cent., and Vermont 3.8 per cent., which accounts for approximately 65 per cent. of the total retail sales.

I might add that prior to that piece of business being done we sent one of our men into the territory, who spent about

two weeks' time with members of our St. Louis office talking about the virtues of the Missouri Power and Light Company. We put on a special drive to see what we could do in the way of distribution in that State, which I think accounts for the fact that that amount of bonds went into the State of Missouri.

Q. Could you state the percentage of bonds that did go

—7,140—

into that State? A. Yes. About 8.3 per cent.

Q. And that included St. Louis as well as the entire State? A. Yes. It included St. Louis.

9056

Q. Very briefly, what were the results in the case of the Wisconsin Gas and the Wisconsin-Michigan as to placement in Wisconsin? A. In the Wisconsin Gas & Electric ten-and-a-half-million issue 16.4 per cent. of the bonds were retailed in the State of Wisconsin, with approximately 43 per cent. in New York State.

Q. The Wisconsin figures include the entire State? A. The entire State. The bulk of the sales would probably be in and around Milwaukee.

Six States accounted for about 85 per cent. of the distribution.

9057

In the case of the Wisconsin-Michigan Power Company likewise there was a ten-and-a-half-million-dollar issue, with 12 underwriters and with 96 selling group members. 16.6 per cent. of the bonds were retailed in the State of Wisconsin, with 44.6 per cent. being sold in New York State.

Those bonds, I might add, were legal for savings banks in New York State at that time. We were in a market where

9058

Duncan R. Linsley--By Respondents--Direct

the savings banks and trust funds in New York were active
—7,141—

buyers of these high-grade utility securities.

Q. Do you happen to have the percentage of the placement in the State of Michigan in the case of the last-named company? A. I can get it if you want it, in the record, which is right here.

9059

Q. Will you do so? A. There were \$43,000 principal amount of bonds sold in the State of Michigan at retail, or four-tenths of one per cent.

Q. In these last two named cases, that is, Wisconsin Gas and Wisconsin-Michigan, was every effort made to obtain the greatest possible local placement? A. There was.

9060

Q. On the basis of the First Boston's experience what would you say as to in what States the best investment markets exist? A. Of course, it follows really the law of supply and demand. Our records show that for the 6-year period from 1935 to 1940 the First Boston Corporation headed syndicates involving the distribution of about a billion and two hundred millions of securities. The entire retail distribution by States of that amount of securities expressed in percentages was as follows: New York State 32 per cent., Massachusetts 12.2 per cent., Pennsylvania 10.4 per cent., Illinois 6.8 per cent., California 4.7 per cent.,
—7,142—

Connecticut 4 $\frac{1}{4}$ per cent., Wisconsin 3.6 per cent., and New Jersey 3.4 per cent.

Q. These percentages relate, do they, to the underwritings and participations of all members of the selling groups or the underwriting groups in each case? A. That is correct.

Duncan R. Linsley—By Respondents—Direct

9061

Q. They are not simply the First Boston's distribution?

A. It is all underwriters and selling group members who pursuant to our request have answered the questionnaire regarding the geographical retail distribution of the securities.

It is rather interesting to note that the first three States of New York, Massachusetts, and Pennsylvania accounted for 54½ per cent. of the total buying, and that the eight States which are mentioned accounted for about 77 per cent. of the total distribution.

9062

Q. Has it been your experience that it is harder to sell public utility common stock than it is to sell public utility bonds or preferred stock? A. Very much so.

I think there is one thing that is interesting in connection with that question about the North American diversification of their property, and that is the fact that in spite of the conditions that have been existing today, a study of the article entitled "Fifty Stocks Investment Trusts Pre-

—7,143—

fer," which appeared in Barron's Financial Weekly of February 10, 1941, shows that of a list of fifty stocks that were held in investment trusts, the five most popular stocks are as follows: Chrysler Corporation was held by 45 trusts, Montgomery Ward by 41, Kennecott Copper by 41, North American by 40, Union Carbide and Carbon by 40; and if you go down the list it is rather significant, I think, to find that the American Gas & Electric Company common stock is held by 27 trusts; the Commonwealth Edison Company, which in the trade is looked upon as one of the most popular utility equities today, is held by 18 investment trusts.

9063

9064

Duncan R. Linsley—By Respondents—Direct

Q. Those are the only utility holding companies, I suppose, or are there others? A. No. There are included in the list of the fifty, lower down, at the end of the list, Niagara Hudson Power common, and the Commonwealth and Southern preferred stock.

But the thing that is striking is the fact that the North American today ranks right up with the leading stocks in the country as being the most popular with a type of buyer that is pretty well informed on current conditions.

9065

Q. And that is the North American common stock, is it?

A. That is the North American common stock.

While I don't know what is in the minds of these investment groups, I am of the opinion that the combination of the regard in which the management is held together with

—7,144—

the diversification in their earnings power, is probably largely accountable for that size holdings.

Mr. Hamilton: That is all.

9066

(Whereupon a recess was taken from 12:55 to 2 o'clock p. m.)

Duncan R. Linsley—By Respondents—Cross

9067

AFTER RECESS

The hearing was resumed at 2 o'clock p. m., at the expiration of the recess. DUNCAN R. LINSLEY, the witness on the stand at the time of taking the recess, resumed the stand and was examined and testified further as follows:

Cross Examination By Mr. Binford:

Q. Mr. Linsley, you spoke of the attractiveness in the 20's of the securities of the North American Company from the standpoint of diversification of the holdings of the North American Company. Do you know what the diversification of holdings consisted of at that time of that Company of which you spoke? A. I believe, just from memory, without having refreshed my memory, that in the middle and late 20's with the exception of the North American Light and Power group of properties, that the major properties were substantially the same as they are today.

9068

—7,145—

Q. Do you feel that the additional investments made in North American Light and Power Company by the North American Company in the period subsequent to 1930 increased the attractiveness of the North American Company securities by reason of the diversification effected? A. No. ~~I wouldn't necessarily say so.~~ I think that the increased investment in the North American Light and Power Company to some extent at least was brought about by conditions over which the North American Company had no control.

9069

Q. However brought about, the result was a distribution of the investments in the aggregate for the North American

9070

Duncan R. Linsley—By Respondents—Cross

Company over a greater spread of properties than it was theretofore? Is that correct? A. That is correct.

Q. In other words, a greater spread of diversification of the investments sold? A. Well, you might say, a greater geographical diversification. But, if my memory is correct, from the standpoint of the North American Company proper, they haven't had any benefits in the form of income from their equity holdings in the North American Light and Power group.

9071

Q. So diversification in and of itself does not necessarily result in benefits to a holding company, does it? By diver-

—7,146—

sification I mean geographical diversification. A. I think that geographical diversification is of considerable value to a holding company. Of course, with that you have got to have good management, intelligent management. You have also got to have materials with which to work. I mean by that that you have got to have materials in the operated operating, which, after all, are the source of earnings and earning power to the security holders, the original source of such earning power.

9072

Q. Prior to the investment by the North American Company in the North American Light and Power Company system the North American operating properties were very largely in large urban and industrial centers, were they not?

A. That is correct. But scattered geographically.

Q. But the principal operations were, I believe, in St. Louis, Cleveland, Washington, D. C., and in Milwaukee?

A. In Milwaukee, and to a certain extent there was a diversity of income from their holdings on the Pacific Coast, of

which the most important city, of course, would be San Francisco.

Q. And, of course, there was present a further investment in the Detroit Edison Company, which was also operated in an industrial section of the country? Isn't that true?

A. That is correct.

Q. What was the period covered by your statements relative to the participation of the First Boston Corporation

—7,147—

in utility underwritings? A. Which underwriting do you mean? My statement about the aggregate of what we have done or the statement with respect to the North American financing?

9074

Q. The North American financing. A. Since the inception of the Securities Act of 1933.

The first issue headed by the First Boston Corporation of a subsidiary or affiliated company of the North American system was in November, 1935, at the time the \$30,000,000 of bonds of the Kansas Power and Light Company first mortgage bonds were sold.

Q. That syndicate was headed, you say, by the First Boston Corporation alone? A. The First Boston and Dillon Read and Company.

9075

Q. When was the First Boston Corporation organized? A. That is a little complicated story, but briefly, it took its present form in June, 1934.

Pursuant to the Banking Act of 1933 the security affiliates of national banks were required to be dissolved, and a deal was worked out with the First National Bank of Boston and with the Chase National Bank whereby the First

9076

Duncan R. Linsley—By Respondents—Cross

of Boston Corporation, which was then in existence as a security affiliate of the First National Bank of Boston, changed its name to "The First Boston Corporation" and its stock was offered to the stockholders of the Chase and the stockholders of the First National Bank of Boston; and in

—7,148—

turn the stockholders of each would have the right to subscribe to not more than 45 per cent. apiece under the terms of the Banking Act; and at that time certain executives and personnel that had formerly been with the Harris organization joined with the personnel of the First Boston to form what I call the First Boston Corporation when it took its present form in June, 1934. That may sound a little complicated, but in essence that is what the transaction was.

9077

Q. What was the next issue of the North American system in which the First Boston Corporation participated? What, rather, was the first after the formation of the First Boston Corporation? A. You mean now any participation rather than our having headed the business?

9078

Q. Yes. But not excluding that which you headed. A. I believe the first issue was the \$40,000,000 principal amount of the Cleveland Electric Illuminating Company, then called the general mortgage (now first mortgage 3¾ per cent. bonds due 1965, which were offered to the public on July 15, 1935. I believe that that was the first North American Company subsidiary financing in which the First Boston Corporation participated as one of the underwriters.

Q. What was the extent of the participation of the First Boston Corporation? A. I don't believe that I have that record available with me.

—7,149—

Q. Do you recall who headed the underwriters, the syndicates? A. Dillon Read Company, and I believe from memory that the First Boston Corporation appeared in second position in the business.

Q. What was the next issue of the North American Company or its subsidiary companies in the underwriting of which the First Boston Corporation participated? A. The next issue of a subsidiary of the North American Company in which the First Boston Corporation participated was the \$30,000,000 first mortgage bond issue of the Kansas Power and Light Company, which I referred to a few moments ago, which was offered on November 25, 1935. 9080

Q. And that was the issue in which the First Boston Corporation shared with Dillon Read? A. That is correct. The First Boston appeared as leader of the financing, but managed the issue jointly with Dillon Read and Company.

Q. What was the next issue of the North American system in which the First Boston participated? A. I believe the next issue was an issue which First Boston Corporation headed, namely, \$10,500,000 of first mortgage bonds of the Wisconsin Gas & Electric Company, offered to the public on April 20, 1936. This issue was headed by the First Boston Corporation. 9081
—7,150—

Boston Corporation.

Q. Not with any other underwriting firm? A. That is correct.

Q. And the next issue of the North American Company system in which the First Boston Corporation participated as underwriter was what? A. When you refer to the system, I am excluding the issues of the Pacific Gas & Electric Com-

9082

Duncan R. Linsley—By Respondents—Cross

pany and the Detroit Edison Company, in which the North American Company has a substantial minority interest.

The next issue we did not participate in, which was the Potomac Electric Power, which was offered in June, 1936.

Q. Do you know what underwriting firm managed that issue? A. As I recall it from memory, those bonds were offered for competitive bidding.

Q. Under a rule of the Public Utilities Commission of the District of Columbia? A. That is my recollection.

9083

The next issue which the First Boston Corporation participated in was one which we headed, namely, \$10,500,000 of first mortgage bonds of the Wisconsin-Michigan Power Company, offered July 31, 1936, such issue being managed by the First Boston Corporation alone.

Q. Will you take up the next one?

—7,151—

Mr. Hamilton: There are quite a good many of them.

By Mr. Binford:

9084

Q. How many of these issues were there of the North American system in which you participated since the date of the organization of your corporation, approximately? A. I couldn't tell you the number without referring to the records. I believe that we have participated in, as I testified before, practically every issue with the exception of the Potomac Electric Power.

Q. Do you recall how many of those issues were headed in respect of underwriting by firms other than the First Boston or Dillon Read? A. I don't recall. I wouldn't want

to answer that without looking over the entire list to make sure.

May I inquire whether counsel's question is limited to situations where the First Boston itself has headed the participation or whether he refers to all of the North American?

Q. The question as stated referred to those only in which the First Boston participated. A. I couldn't give you the answer to that without looking it up.

Q. Do you recall a single instance in which an issue was made through underwriters in which either Dillon Read or the First Boston Corporation was not a principal underwriter or manager? A. Yes, I do, now that I think of it. The

—7,152—

issue of Wisconsin Gas & Electric Company $4\frac{1}{2}$ per cent. preferred stock in July, 1939. The issue of Wisconsin-Michigan Power Company $4\frac{1}{2}$ per cent. preferred stock in December, 1939. The issue of Wisconsin Electric Power Company $4\frac{3}{4}$ per cent. preferred stock in May, 1940. If my memory is correct, these three issues were headed by houses other than Dillon Read or the First Boston Corporation.

Q. In each instance the house heading the issue was a local dispensing house, was it not? A. I believe that the house heading the issue was The Wisconsin Company.

Q. And the preferred stock was issued in connection with an exchange in each of those cases for previously outstanding preferred stock largely held within the State of Wisconsin?

A. That is my recollection, although I am not certain whether there was in any of these cases any stock offered for cash.

Q. But insofar as national distribution had been considered, that is, distributions which were not largely within one State, do you recall any instance in which Dillon Read

9088

Duncan R. Linsley—By Respondents—Cross

or First Boston Corporation have not headed the underwriting syndicate involved? A. I do not remember any at the moment.

—7,153—

Q. In connection with the underwriting of bond issues does the First Boston Corporation in cases in which it is a principal underwriter assist in the formulation of the plan of financing adopted, that is to say, the indenture provisions and matters of that kind? A. We do.

9089

Q. To what extent do you assist the issuing company in that respect? A. The practice varies a great deal in different cases, so that you cannot make a general statement that would be applicable to all situations. In general it is our practice, preliminary to doing a piece of business, to have thorough discussions in our own organization as to the form of the financing, as to the market prices which might be realized or the types of securities to be offered, and as to a general outline of the major indenture provisions which we feel are necessary.

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These items, of course, we are in a position to have an opinion about due to our day-by-day dealings in securities. We are familiar with where the market exists at the moment in particular types of securities, what the market is willing to pay for those types of securities, and what the market demands in the way of what they consider appropriate indenture provisions.

It is then usually the practice to sit down and discuss

—7,154—

in some detail with the company officials different aspects in connection with the financing of the enterprise. There

are a great many points of difference that are discussed pro and con. Oftentimes we find from experience that there are certain quirks to mortgage provisions that they have learned by experience can be improved upon to simplify the operation under the indenture or to save expenses. There is a general exchange of ideas with the company officials which after a period of time results in the child being born.

Q. Now, do insurance companies and other institution investors from time to time seem to acquire a liking for new types of indenture provisions with which they have become familiar or which they have formulated? A. They do.

Q. Have you kept in touch with that tendency upon the part of institution investors? A. We have.

Q. How large is your staff? A. We have approximately 400 employees.

Q. Among those employees are there any persons who specialize with indenture provisions? A. Yes. There are, I should say, probably eight or ten individuals.

Q. In connection with underwriting bonds issued under indentures, do you employ attorneys at law in your under-

writing operations? A. We do.

Q. Do you have such counsel regularly retained? A. Not regularly retained. We use several firms for that work.

Q. You, of course, select the firms with regard to their corporate experience and ability? A. That is correct.

Q. What is the largest utility bond financing that you recall that your company has participated in in which the issuing company was not a subsidiary of a registered holding company? A. On October 9, 1940, the Southern California

9094

Duncan R. Linsley—By Respondents—Cross

Edison Company issued \$108,000,000 principal amount of first and refunding mortgage of 3 per cent. bonds, which financing was headed by the First Boston Corporation. I believe that is the largest issue that we headed to date. We have also participated as one of the major underwriters in the financing of the Commonwealth Edison Company.

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Q. What was the time of the issue of the Commonwealth Edison Company in which you participated? A. There were several deals during 1938 and, I believe, 1939; but, as I recall now, those were small. The large Commonwealth Edison Company was the private deal done directly with the insurance companies.

—7,156—

Q. In respect to the private deal done direct with the insurance companies do you recall the amount involved? A. As near as I can recollect, it was about \$114,500,000.

Q. Do you recall the cost of the money to the company? A. Not offhand. No, sir.

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Q. Would you state approximately what it was, as near as you can recall? A. I don't recall. It doesn't show in the report of the Public Utilities Commission and the Securities and Exchange Commission. I recall now why it doesn't—because it was neither registered under the Securities Act nor under the Public Utilities Holding Act. I don't happen to remember offhand.

Q. Do you happen to remember offhand how the price paid for the money securities at this private sale compared with the price being paid by other utility companies for money at the same or at approximately the same time? Was it lower or higher than was being paid by subsidiaries of

other holding companies of at all comparable characteristics?

A. I do remember that there was a lot of talk at the time about the price at which the issue was sold, and a feeling on the part of a great many people that the company could have done better with a public distribution of the securities. It just happens that I knew at the time that the war clouds were gathering abroad, and there was no telling what might

—7,157—

develop from a market point of view over the period of 90 days' time, and that the management of the Commonwealth Edison Company after considering the matter very thoroughly decided that they should move with speed, and they chose to do a private deal because by the time they got through registering that deal and waiting the 20-day period, perhaps 60 days or 90 days might elapse and they might miss the market.

9098

That, incidentally, was prior to the time that the Securities and Exchange Commission worked out the mechanics for acceleration of the registration statements.

I also recall that while the money did look as though it was a little higher than could be obtained, I personally had some sympathy with the management of the Commonwealth Edison Company's point of view, because the outlook was so dark abroad that it was a pretty moot question as to whether the management wanted to gamble on a 30-or 60-or 90-day delay; and the only way you can tell you are right is looking at it in retrospect.

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Q. Do you think that the Commonwealth Edison Company had to pay a higher price for the money which it secured through this bond issue than it would have had to pay if it

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Duncan R. Linsley—By Respondents—Cross

had been a subsidiary of a registered holding company? A. I don't see how you could really answer that question. It is really little hypothetical.

—7,158—

Q. Yes. It is hypothetical. A. I don't know how you would answer it, frankly.

9101

Q. Don't you have any opinion upon that subject? A. I know that the Commonwealth Edison Company is from a credit point of view very highly regarded among investors.

Q. You say it is so regarded in spite of the fact that it is not a subsidiary of a registered holding company, or is the fact that it is not a subsidiary of a registered holding company—does that have nothing to do with the question? A. I think it is highly regarded because of the fact that it is servicing a very important section of the country, namely, in and around Chicago; and its policies have been conservative.

9102

Q. Its last bond issue, the Cleveland Electric Illuminating Company, received a very good price for its bonds, did it not, in comparison with the price obtained by other companies? A. It did.

Q. Do you attribute that fact to the credit standing of that company or to the prestige associated with its holding company connection? A. I think that the credit standing of that particular company plus the fact that over a long period of years it had the benefit of the North American

—7,159—

Company management were responsible for getting the price that it did.

Q. You mean that it probably reached its credit standing because of the efficiency of the previous North American management, that is, the North American management brought it up to the position which it occupied at the time of this bond issue in respect of credit? Is that it? A. I think that credit is not created overnight. Credit only results over a period of time, and I think that the fact that it was managed by the North American Company had a lot to do with establishing that credit over a period of years.

Q. It is your opinion that if the North American Company were not the majority stockholder of the Cleveland Electric Illuminating Company, the credit of the Cleveland Electric Illuminating Company would decrease? A. Well, that is a rather difficult question to answer. From the standpoint of the senior credit, and by that I mean the first mortgage bond credit, that is already established today. When you get down to the step when it is your equity credit, all of which goes to make up your equity credit—by equity credit I mean the preferred and common stock—with respect to common stock, I am certain that one of the most important factors that would have to be answered if that common stock were publicly distributed, let us say, would be the manage-

—7,160—

ment aspect of it. At least, that has been our experience in the reaction in the minds of investors in some of these other common stock fields that we have had anything to do with.

Just for example, there was a great deal of discussion, and has been a great deal of discussion, on that point in this issue that was offered today of the Connecticut Light and Power Company.

9106

Duncan R. Linsley—By Respondents—Cross

Q. Mr. Hamilton asked you several questions bearing upon diversification as a factor in investment value. In your answers you cited the Standard Gas and Electric Company system as a case in which there was a large concentration in that company in one particular locality, namely, in and around Pittsburgh. It is true, is it not, that until recent months the Standard system has controlled the San Diego Gas & Electric Company, operating in and around San Diego, California, and the Mountain States Power Company operating in the Pacific Northwest, and the California-Oregon Power Company, likewise operating in the Pacific Northwest?

9107

A. It is true that they have until recently had control of those properties. But, if my memory is correct, for quite a period of time they received no income on either Mountain States or California-Oregon Power Company; in the case of Mountain States because of the fact that that company had arrearages on their preferred stock, and likewise in the case

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of the California-Oregon, that it had arrearages and, I think, still has on its preferred stock, so that there was no income coming to the Standard Gas and Electric Company on those equities.

9108

So that while they had title to those assets, there was no diversification with respect to those as far as income is concerned.

Q. The Standard System also controls the Northern States Power Company of Minnesota and the Northern States Power Company of Wisconsin, does it not, operating in those respective States? A. I am pretty certain they don't control the Northern States Power Company of Minnesota. All

that stock is owned by the Delaware Company, and they have no voting control of the Delaware stock. They certainly haven't been getting any income on it.

Q. You know, however, that the companies which I have named are subsidiaries of the Standard Gas and Electric Company within the meaning of the Public Utility Holding Company Act and are subject to regulation thereunder? A. I presume so. I don't know just what the definition of a subsidiary company is in the Holding Company Act. It is certainly an affiliated company. But in the case of the Northern States Power Company of Delaware, there is no voting control there, and there is no income coming to Standard

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from those holdings.

Q. Of course you are confining your answer to the present time as distinguished from the past? A. Yes. But to the best of my knowledge and belief, there has not been any income for some years on that. That is, I mean, certainly not in the last three or four years.

Q. When you spoke of the Standard System as being one not characterized by diversification, you were referring to the fact that its income had practically ceased in respect of any properties except those in the Pittsburgh area? A. No. I meant—

9111

Q. In that its original investment had not been made on a deliberate geographical basis. A. No. I meant that the income is, and has for some period in the past been, to a great extent dependent on the income from the Philadelphia area, and that there is no geographical distribution of income, as there has been for some of the properties.

9112

Duncan R. Linsley—By Respondents—Cross

Q. Even though there is geographical distribution of the investments? A. Even though there may be some geographical distribution of the investments. But, as near as I can recollect, it has always been true that the bulk of the Standard income has come from the Philadelphia area.

Q. By Philadelphia area you mean the area served by

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the Philadelphia Company? A. The area served by the subsidiaries of the Philadelphia Company, which in itself is a holding company.

9113

Q. Is there a term in general use in investing banking circles of "historic position" with reference to the relationship of an underwriting firm to the issuer? A. There is.

I might add that the general feeling, I know, insofar as our firm is concerned, is that if we have done a good job for the company in the past, and have worked, as we feel we do, in the interests of the company in trying to secure prices that are fair both to the company and to the investing public, that certainly that performance of service should be an element of consideration when the next piece of business comes along.

9114

Q. Would your firm likewise hesitate to approach a prospective issuer with a view to heading an underwriting when you knew that for many years past another investment house had usually headed its issues, that is, the issues of this particular prospective issuer? A. If we felt that a company had a favorable relationship with a banking house over a long period of years, and that house had performed for the company, we would not go out and aggressively try to take the business away from them. At the same time, it

would not preclude us from talking with the company and

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giving the benefit of whatever ideas we had. On the other hand, if we felt that a house had not performed, or had reasons to believe that they had not performed, we would have no hesitancy about talking to the company about it.

Q. Do you consider that the First Boston Corporation and Dillon Read and Company or either of them occupy a historical position of leadership in respect of issues by companies of the North American System? A. I think that both Dillon Read and Company and the First Boston Corporation have done over the years what I consider some good jobs for various companies in the North American Company system; and I would naturally hope that when a new piece of business came along, the management of the company involved would at least be in a receptive frame of mind.

9116

Q. You would expect in fact first consideration, would you not, for your two firms? A. But, of course, with this new rule—what is it—Rule 50—going into effect, I think that it is sort of an academic question.

Q. The rule has not yet gone into effect. A. It is going into effect on May 7, isn't it?

9117

Q. Yes, if I recall correctly.

But, leaving the rule as to the future out of consideration, you would normally expect in the case of a new issue by a North American Company that your firm or that of

—7,165—

Dillon Read would be given first consideration?

Mr. Hamilton: I ask that the question be clarified as to whether the question contains the assumption that the rule does not exist in the future.

9118

Duncan R. Linsley—By Respondents—Cross

Mr. Binford: It contains an assumption that at the time of operation the rule has not yet been in effect.

Mr. Hamilton: Is the question limited, then, to any possible transaction between the present and May 7, 1941?

Mr. Binford: Yes.

9119

A. I would be very much disappointed in between now and May 7 if, for instance, the Kansas Power and Light Company wanted to do a piece of financing and they would not come to us about it.

By Mr. Binford:

Q. Do you think Dillon Read would feel similarly in that respect? A. I don't know. Dillon Read would have to speak for themselves.

9120

Q. But you do know what the historical practice is? A. Oh, I do know. As I say, we would be very much disappointed, although they (the Company) have a perfect right, and always have had, to deal with anyone that they please about picking the people that they want to do business with. We feel, however, and we would like to believe, that the

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reason they select the First Boston Corporation is that they have been satisfied with the jobs that we have done for them in the past. We like further to believe that they have known the members of our organization over a long period of years and have confidence in what we tell them.

Mr. Binford: I have no further questions. I would like to make the same reservations as heretofore made in respect of other witnesses.

F. W. Doolittle—By Respondents—Direct

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Mr. Hamilton: The usual objection, Mr. Examiner, if you please. That is all.

The Examiner: All right. The record will show that.

(Witness excused.)

Whereupon, F. W. DOOLITTLE, being called as a witness on behalf of the Respondent, and after being first duly sworn, was examined and testified as follows:

9122

Direct Examination by Mr. Browning:

Q. Will you give your full name and address to the reporter? A. F. W. Doolittle. Garden City, New York.

Q. Will you please outline briefly your education and business experience, Mr. Doolittle? A. I graduated from Princeton University in 1905 with the degree of B. A., and

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from the University of Colorado with the degree of Bachelor of Science in civil engineering in 1907; and in 1911 received an advanced degree in engineering.

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My early professional experience, some of which was in vacations, comprised field and office work in connection with the maintenance department of the Union Pacific Railroad; steel and concrete structural design for the Chicago, Milwaukee & St. Paul Railroad; operation and construction work mostly in the field with the Boston Consolidated Mining Company of Utah; and operation and construction work with the Consolidated Coal and Coke Company in Colorado.

In the fall of 1908 I went to the University of Illinois as instructor in mechanics and hydraulics. After a year there

9124

F. W. Doolittle—By Respondents—Direct

I spent a year as instructor in structural engineering at the University of Colorado. The three following years, 1910 to 1913, I was assistant professor of mechanics in the College of Engineering at the University of Wisconsin; and also covering the same period and extending into the fall of 1913 I was engaged in research and case work for the Railroad Commission of Wisconsin, dealing primarily with transportation costs in connection with freight and passenger rates.

9125 In the fall of 1913 I became the first secretary with the title of Acting Secretary of the Public Utilities Commission of Illinois.

Sometime about the middle of the following year, after a
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brief job with the Milwaukee Electric Railway and Light Company, which is now the Wisconsin Electric Power Company, and which incidentally formed my first contact with the North American System, I went to New York as director of the Bureau of Fare Research of the American Electric Railway Association.

9126 My work with this bureau terminated at the end of the year 1915, and from the beginning of 1916 until sometime in 1923 I was consulting engineer on retainer throughout practically the whole of the period, as I recall it, from the North American Company or its subsidiaries, and devoted perhaps half of my time during that period of upwards of seven years to the work of the North American group of properties.

The balance of the time was devoted to work for other companies, practically all of which were public utilities operating railway, gas, electric, heating, and such businesses, although I did some work during that period also for the Chicago, Milwaukee & St. Paul Railroad.

F. W. Doolittle—By Respondents—Direct

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From the beginning of 1923 and continuing until, I believe, December 1, 1936, at which time I retired, I was vice president of the North American Company. From 1926 to 1936 I was a member of the executive committee; and from 1935 to date a director of the North American Company. And during the period from 1923 to 1936 I was an officer and director of various of the subsidiaries and affiliated companies in the North American group.

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I retired as an officer of all companies in the North American group in 1936, but have since that date been on retainer with the North American Company as a consultant in general problems that arise; and I have also continued as a director of their affiliated companies in Washington, that is, the Washington Railway & Electric Company, the Potomac Electric Power Company, and the Capital Transit Company. I am also a director of the Illinois Terminal Railroad Company. 9128

My service as director has not been continuous with the Washington affiliates of the North American Company, as I have been away from this part of the country from time to time; and, at least in the case of the Capital Transit Company, the vacancy created by my absence was filled in my absence, and then I was re-elected upon my return. 9129

During my association with the North American group of properties, which began in 1914, but which has been practically continuous from 1923 to date, my activities have been primarily concerned with engineering and operating matters as distinguished from corporate financing matters; although the North American Company officers throughout

9130

F. W. Doolittle—By Respondents—Direct

the whole of my contact with that company operated to some extent as a committee, that is to say, the lines of authority and interest have not been precise in all cases.

As an example, certain of the officers who are not engineers have passed on operating and engineering problems;

—7,170—

and I in turn have participated in the negotiation of bank loans and of such matters, although my attention was by virtue of my prior experience primarily devoted to problems of engineering and operation.

9131

Q. Mr. Doolittle, are you familiar with the operations of the Station Advisory Operating Committee and the Intercompany Electrical Committee? A. Yes. I have followed the work of those committees practically from their inception.

Q. When were the committees first formed? A. The Station Advisory Operating Committee held its first meeting in February, 1921, and the Intercompany Electrical Committee in March of the same year. Both meetings were held in Cleveland, and the organization meetings were attended by Mr. Ruffner, at that time a vice president of the North American Company.

9132

Q. What was the origin of the two committees? A. The setting up of these two committees grew out of a desire on the part of the officers of the North American Company to obtain the best possible technical results through the interchange of experiences of the operating men on the several properties.

As the first step Mr. Ruffner, who prior to that time had operated the St. Louis County Gas Company and subsequently the Union Electric Light & Power Company, was

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brought to New York by Mr. Mortimer, the president of the

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North American Company, for the purpose of promoting the exchange of experiences and the best possible engineering practice amongst the operating properties.

I cannot say whether Mr. Mortimer or Mr. Ruffner or Mr. Gruhl, who was at that time also an officer of the North American Company, first conceived the idea of the Inter-company Electrical Committee as a means to the end. I do know that out of this group of men this result came.

9134

Q. What has been the membership in these committees?

A. Originally the Milwaukee Company and the St. Louis Company, subsidiaries of the North American Company, in which Central States had a substantial investment, that is, the Central States Electric Corporation, together with the Cleveland and Youngstown, also owned by the Central States Electric Corporation, together with Detroit, in which the North American Company had a large interest.

Q. Were there any substantial changes in the membership? A. Yes. In 1923 the representative of the Youngstown property went off the committees.

9135

Q. Did that action take place after any change of control of the Youngstown properties? A. Yes. That took place at the time the Central States Electric Corporation sold its interest in Youngstown.

In 1929 the Potomac Electric Power Company, after the

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North American's acquisition and after certain developments, had representatives on the two committees.

9136

F. W. Doolittle--By Respondents--Direct

Representatives of the Great Western Power Company and the San Joaquin Light and Power Corporation became members of the Intercompany Electrical Committee.

Q. That is, only as to that committee? A. Yes. Only the Intercompany Electrical Committee.

At the time of the acquisition by the North American Company of an interest in the Western Power Corporation, which was the parent company of the Great Western and San Joaquin at that time.

9137

These representatives went off these committees about 1931 or 1932.

Q. Was that following any sale by the North American of its interest in the Western Power Corporation? A. Yes. I don't recall the date, but I think it was about 1930 that the North American Company disposed of its interest in Western Power to P. G. & E.

9138

Representation of these western companies, the Great Western and San Joaquin, was confined to the Intercompany Electrical Committee, because those two California companies had no comparable steam generating properties with the other subsidiaries of the North American Company, their generation in California being primarily very high-head hydro.

I think that covers the changes in company membership.

—7,173—

There have, of course, been numerous changes in the individuals who represented these companies as men died or for other reasons it was necessary to appoint successors.

Q. Can you tell us generally how the organization of the committees has functioned? A. The committees choose

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their own chairman. This office of the chairman has rotated from time to time among the committee members.

The committees each have a secretary, it being the same man in each case, however, who handles certain statistical work for the committee, its minutes, its notices of meetings, and functions generally in the capacity of secretary.

Q. Where are the meetings held? A. Almost always on one or the other of the operating properties, rotating, but varying the place of meeting occasionally when some important piece of equipment is to be brought into service, or when for some other reason the members of the committee may happen to be brought together elsewhere. But generally speaking the meetings are held on the properties; and they frequently are arranged so that an inspection trip of new or special apparatus of some sort can be combined with the other subjects handled at the meeting.

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Q. Are these committee meetings valued by the respective company officials? A. I think they are very greatly. They are particularly valued because under the way these com-

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mittees are set up and functioning we have men of large experience and ability of substantially coordinate corporate position, free to discuss their problems with each other, and they understand that it is the desire of the heads of their companies that they shall speak frankly on their failures as well as their successes.

9141

Q. Are the meetings informal? A. Yes.

Q. Is this informal and free interchange a matter which is easily secured? A. No. It is most difficult to secure.

9142

F. W. Doolittle—By Respondents—Direct

I might illustrate with certain problems that I faced as Director of the Bureau of Fare Research of the American Electric Railway Association.

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This was a department of a membership organization set up for the purpose of studying in general two things: First, the relative advantages of regulation by contract, that is, by ordinance, and regulation as a continuous process under a state regulatory commission. The other matter of primary consideration was a study of the basic costs of transportation in an effort to determine what were the points of weakness and what were the points of strength from an economic standpoint in city transportation as rendered by street railway as compared with other forms of transportation which were then first coming into use, such, for example, as the

—7,175—

so-called jitney, which was the prototype, shall we say, of the modern bus.

9144

It became evident after several months that the value to the owners and operators of the various railway companies which they hoped to get from the studies, as to full and complete information on costs and on problems of regulation, was not to be forthcoming. The men operating these companies were busy with their day-to-day problems. There was no financial interest back of them which would suggest to them that perhaps they should cooperate fully to their own advantage.

The net result was that after about six months I went to Milwaukee, which I think has one of the longest records of regulation by a state commission, and to Cleveland, which has, I am sure, the most interesting history of attempts to

regulate by contract bargaining; and assembled a small staff in each place, and practically lived on those properties until I could get together the information which was necessary.

Both companies were extremely anxious to get the results and were interested in the results of my studies. Once having reduced them to manuscript form, they then went after me and corrected me in several instances in misconceptions which I had. But, if left to them, I should never have been able to get the information.

I had similar experiences as chairman of committees on 9146

—7,176—

valuation and depreciation of the American Electric Railway Association and as a member of the Accounting Committee and of the Railroad Electrification Committee of the National Electric Light Association.

Those are illustrations of the difficulty of getting a full and frank and free discussion of the successes and failures on a totally cooperative basis.

Q. I take it that you feel that there is a difference between a general industrial committee or committee between non-affiliated companies, and the North American intercompany committees? A. Yes. A very distinct difference. 9147

Q. Does the common financial interest have anything to do with the success of the North American intercompany committees? A. I think that is a controlling factor.

Q. In your opinion will those committees continue if the present ties are broken? A. No. I am sure they would not.

Q. Do you know of any group similar to the North American intercompany committees which exists among non-affiliated companies? A. No. I don't know of any, and

9148

F. W. Doolittle—By Respondents—Direct

I think over the years I would have known of them if they were in existence. But a categorical answer is no. I do not know of any such.

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Q. Do you think that the possible loss of personnel would be a factor militating against such a committee existing among non-affiliated companies? I should add that by loss of personnel I mean the possibility that one of the non-affiliated companies might attempt to acquire personnel of another. A. I think that is a rather real danger, although I didn't have any idea that that was what you were getting at in the question when it was originally asked. An operator is always reluctant to let his best-grade men parade their excellence before other possible employers. Unfortunately there is from time to time what might be termed pirating of personnel, and I should think that might be a very real reason why an operator might be reluctant to let his men whom he considers especially valuable display their proficiency before other employers.

9150

Q. Do you consider that the North American intercompany committees constitute any stimulus to the participating engineers? A. Oh, I think so. Membership on those committees is not only of an educational value to the members through the contact that they have with other members of the several committees; but, since there is to be a full and frank discussion of the results, and since the results are constantly reduced to statistical form and circulated to the other companies, it is quite natural that the members of the

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committee are going to be stimulated to do their very best

F. W. Doolittle—By Respondents—Direct

9151

at all times and not be caught, if possible to avoid it, in any unfavorable comparison.

Q. I believe you said a moment ago that informality was difficult to achieve. Have you at times tried to encourage the atmosphere of informality? A. Yes. Definitely. And that has been achieved in my judgment to a considerable extent by first keeping the personnel on each committee made up of men of about the same position in their respective companies.

I might say in addition that, although the officers of the North American Company from time to time, as well as officers of the subsidiary companies from time to time, have met with these committees, it has never been as a presiding officer, and never with the idea of controlling the discussion; but rather to indicate in a rather casual way the fact that we appreciate the excellent work that has been done, and we hope that they enjoy it, and we want to have them continue to do it as a permanent thing. 9152

Q. Mr. Doolittle, do you have with you a set of minutes of the two committees? A. Yes.

Q. Will you please produce them? 9153

(The witness produced two suitcases full of documents.)

—7,179—

Q. These copies that you have with you constitute a complete set of the minutes of the two committees? A. Yes.

Q. And these are copies of those in the records of the North American Company? A. That is correct.

Q. Mr. Doolittle, I hand you the minutes of the 110th meeting of the Station Advisory Operating Committee held

9154

F. W. Doolittle—By Respondents—Direct

on June 18 to 19, 1934, at Milwaukee, Wisconsin. Are you familiar with these minutes? A. Yes.

Q. Are these minutes typical and was this meeting typical of the other meetings held over the years? A. Yes. I think it is. The subject matters covered seem to be a fair sample of the various matters considered at the meetings over the whole period of existence of the committee.

9155

Q. We understand that different matters are taken up at different meetings, but my question was directed to whether the general scope of the minutes, the general nature of the matters covered, was fairly typical. A. I think so.

Mr. Browning: I offer these minutes in evidence as Respondent's Exhibit 131.

Mr. Binford: I object to the reception in evidence of the proffered exhibit in the absence of a statement

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of counsel for the Respondents as to what issue in these proceedings this exhibit is directed to.

9156

The exhibit on its face purports to be a record of certain proceedings of the Station Advisory Operating Committee, at which representatives of the Cleveland Electric Illuminating Company, the Milwaukee Electric Railway and Light Company, the Union Light and Power Company, the Potomac Electric Power Company, and the Detroit Edison Company were present. The evidence heretofore adduced on the part of the respondents in this proceeding has affirmatively shown that no two of these five organizations represented at this meeting and upon this committee can be considered as constituting together or in connection

with any one or more of the companies so represented a single integrated system.

So that this proceeding has reached the point at which it seems irrelevant and immaterial to bring in any further evidence as to cooperation between these independent systems as bearing upon the question of what is a single integrated system or as bearing upon the question of what, if any, systems might be retained as an additional system to any integrated single system which might be held as its primary system by the North American Company. 9158

If Mr. Browning and Mr. Hamilton care to state what evidence or effect of value is to be given to this proffered exhibit in connection with any issue in this

—7,181—

proceedings, possibly my objection might be withdrawn. But in the absence of any statement of that character the exhibit on its face is irrelevant and immaterial.

Mr. Browning: We are offering the exhibit for its bearing on all issues in the case; but we should consider it relevant, Mr. Examiner, among other things, for its bearing under subdivision A of Section 11-B 1. It is our position that the combination of these companies in these committees has resulted in substantial economies to the respective companies; and we consider this evidence relevant as bearing on that subject. 9159

Mr. Binford: Mr. Examiner, the evidence as heretofore given in this case as to the localities and operations of these companies geographically is such that

9160

Colloquy

it would seem that the retention of any one of the admitted subsidiaries as an additional system to the Union Electric Company of Missouri as a principal system—

Mr. Browning: Isn't that something that we are going to argue later?

The Examiner: Isn't that something that the Commission has to decide and that you are going to argue as to the state of the record?

9161

Mr. Binford: I think not. I think that is a question of law as to the interpretation of B of Section 11(b) (1) as to whether or not a system not located in

—7,182—

a State adjoining the State of operation of the original system or States contiguous thereto can be retained in any event regardless of the degree of cooperation which may have heretofore been achieved between several systems of that character so distant from each other. That is stating it roughly, but I believe that that was the point that I wish to make.

9162

Mr. Browning: If the Examiner please, the construction of paragraph B is a matter that we understand has been argued at some length before the Commission and is to be passed upon by the Commission and presumably ultimately by the courts. As we all know, various constructions of that subdivision have been made. It seems to me that that is a question of law which should be reserved.

The Examiner: I think these minutes have relevancy, particularly in view of what has been ad-

F. W. Doolittle—By Respondents—Direct

9163

duced as evidence in the very early stages of this proceeding. I recall, Mr. Binford, that you cross-examined at some length about the make-up of these Station Advisory Operating Committees. The record in evidence shows, I think, that this exhibit has relevancy; and I will receive it under the number mentioned.

Mr. Binford: I respectfully except to the ruling.

(The document referred to, being the minutes of the meeting of the Station Advisory Operating Committee held June 18, 1934, was received in evidence and marked "Respondents' Exhibit 131.")

9164

—7,183—

By Mr. Browning:

Q. Mr. Doolittle, I now hand you a copy of the minutes of the 37th meeting of the Intercompany Electrical Committee held on October 27th to 29th, 1931, at St. Louis, Missouri. Are you familiar with these minutes? A. Yes.

Q. Are they fairly typical of the minutes of the Intercompany Electrical Committee? A. In my judgment they are.

9165

Mr. Browning: I offer these minutes in evidence as Respondents' Exhibit No. 132.

Mr. Binford: I would like to ask a question or two concerning these.

The Examiner: All right.

By Mr. Binford:

Q. Mr. Doolittle, the minutes which you have just identified as Respondents' Exhibit for identification No. 132 pur-

9166

F. W. Doolittle—By Respondents—Direct

port to reflect the proceedings of the Intercompany Electrical Committee at a meeting held on October 27th to 29th, 1931, at St. Louis, Missouri. Do you know when these minutes were written? A. I can't answer precisely, but in the normal course of events those minutes are received in the North American office, I should say, not more than two weeks after the date of the meeting.

—7,184—

9167 Q. Was that true in 1931? A. Yes, to the best of my recollection. Illness on the part of the secretary or some other untoward circumstance might delay them, but the minutes are received currently.

Q. And that has been true ever since the formation of these two committees of which you have been speaking?

A. Yes.

9168 Q. To your knowledge was this paper, Respondents' Exhibit for identification No. 132, prepared by the secretary of the meeting which it purports to record? A. The minutes were in the normal course received month by month or promptly after the meetings from the secretary's office in Cleveland. To the best of my knowledge and belief the secretary compiled them from notes taken at the meeting and had them mimeographed in his office and distributed.

By Mr. Browning:

Q. Is it the standard practice of the secretary to mail a copy of each meeting to each of the members of the North American Company or the members comprising the committee? A. Yes. That is the customary practice, the standard practice.

F. W. Doolittle—By Respondents—Direct

9169

Q. That has gone over a 20-year period? A. At least since 1923, eighteen years.

By Mr. Binford:

Q. The mimeographed copy offered in evidence is a copy

—7,185—

recently made from the original record as prepared by the secretary? A. No. I think it is an original, one of those originally made by him at the time, an extra copy from his files.

9170

Q. Made in mimeographed form at that time? A. At that time. Yes, sir.

By the Examiner:

Q. Is that true of the previous exhibit? A. Yes, sir. That statement would cover also Respondents' Exhibit 131.

Mr. Binford: I object to the reception in evidence of the proffered exhibit on the same grounds as objection was made to Respondents' Exhibit 131.

The Examiner: I will receive it in evidence as Respondents' Exhibit 132, and you may take an exception.

9171

(The document referred to, being minutes of a meeting of the Intercompany Electrical Committee held October 27-29, 1931, was received in evidence and marked "Respondents' Exhibit 132.")

Mr. Browning: I would like to state for the record, Mr. Examiner, that we have with us here a complete set of the minutes of the two committees as compiled

9172

F. W. Doolittle—By Respondents—Direct

over the years; and that, while I am entirely willing to offer the entire group of minutes, it seems to me that it would unduly burden the record.

—7,186—

For that reason and that reason alone I have offered the minutes of the meetings which we consider to be fairly typical.

9173

I should also like the record to show that we are delivering to the staff this complete set of minutes; and if the staff wishes to offer the minutes of any individual meetings, we shall be glad to have that done.

The Examiner: Very well. The record will so show.

By Mr. Browning:

Q. These minutes which you have, Mr. Doolittle, show that the meetings of these committees have continued from 1921 up to the present time? A. That is correct.

9174

By the Examiner:

Q. Are all these minutes recognized as the official minutes of these committees as kept by the North American Company as well as the secretary of the committees? A. Yes.

By Mr. Browning:

Q. Could you state, Mr. Doolittle, what are the dates of the last meetings in the case of each committee? A. The date of the Intercompany Electrical Committee was November 12 to 13 in Washington, D. C.

F. W. Doolittle—By Respondents—Direct

9175

Q. Was that in 1940? A. 1940. And in the case of the Station Advisory Operating Committee it was February 19

—7,187—

and 20, 1941, in St. Louis, Missouri.

Q. Are you familiar, Mr. Doolittle, with the statistics interchanged by the constituent companies through the two committees? A. Yes.

Q. Have you brought with you a typical set of such statistics? A. Yes.

9176

Q. Will you produce them?

(The witness produced a number of documents.)

Mr. Browning: Mr. Examiner, again I should like to state for the record that if we attempted to offer in evidence all of the statistics exchanged through these committees, there would be literally thousands of documents. Accordingly, we will avoid burdening the record by submitting a typical set.

By Mr. Browning:

9177

Q. Mr. Doolittle, I hand you a sheet entitled "Comparative Station Operating Data, Period of July 1940 to June 1941, Inclusive." Is this one of the statistical reports exchanged among the constituent companies through the Station Advisory Operating Committee? A. It is. It is prepared monthly in the office of the Secretary of the Committee from data submitted to him by the members of the committee; and when so prepared, circulated to all of the

—7,188—

9178

F. W. Doolittle—By Respondents—Direct

members of the committee and to the North American Company.

Q. This, then, is a monthly report? A. That is true.

Q. Have these reports been so exchanged for many years?

A. Yes.

Q. In substantially this form? A. In substantially this form since the beginning of the committee, except, of course, for the fact that some power plants which were represented in the 20's are not in operation now, and certain new ones do appear in these figures. But the substance of these tabulations is the same.

9179

Q. And this is a fairly typical example of this particular form of report which has been circulated for many years?

A. Yes.

Mr. Browning: I offer the report in evidence as Respondents' Exhibit 133.

Mr. Binford: I object to its reception in evidence on the same grounds as those interposed to Exhibits 131 and 132 of the Respondents.

9180

The Examiner: The exhibit is received in evidence under the number mentioned.

(The document referred to was received in evidence and marked "Respondents' Exhibit 133".)

—7,189—

Mr. Binford: Exception.

By Mr. Browning: .

Q. These column headings on this table refer to power plants, Mr. Doolittle? A. That is correct.

F. W. Doolittle—By Respondents—Direct

9181

Q. And they are respectively Lakeside and Port Washington of the Wisconsin group? A. Yes.

Q. Cahokia of the Union group? A. Yes.

Q. Ashtabula and Avon of the Cleveland group? A. Yes.

Q. Conners Creek and Trenton Channel of the Detroit Edison Company? A. Correct.

Q. And Buzzards Point of the Potomac Electric Power Company? A. Yes.

Q. I now hand you a sheet entitled "S. A. O. C. Comparative Operating Expense Data." Is this a typical report exchanged through the S. A. O. C.? A. Yes. Under identical conditions as described with respect to Exhibit 133. In this case the exhibit deals with operating expenses. In the case of Exhibit 133 the basic engineering data were dealt with, such as kilowatt hours and British Thermal Units.

9182

—7,190—

Q. And again is it true that this form of report has been used in substantially this form over the years? A. This form or its equivalent under slightly different arrangement has existed for many years.

9183

Q. This is also a monthly report? A. That is true.

Q. And this is a fairly typical example? A. Yes.

Mr. Browning: I offer it in evidence as Respondents' Exhibit 134.

Mr. Binford: I object to the admission in evidence of the proffered exhibit on the same grounds as stated in connection with the reception of the last exhibit.

The Examiner: I receive it as Respondents' Exhibit 134.

9184

F. W. Doolittle—By Respondents—Direct

Mr. Binford: Exception.

(The document referred to was received in evidence and marked "Respondents' Exhibit 134.")

By Mr. Browning:

Q. Mr. Doolittle, I now hand you another statistical report entitled "Station Advisory Committee—Comparison of Unit Totals—Production Costs, Month of January, 1941."

9185

Is this another statistical report interchanged through the S. A. O. C.? A. Yes, under the same general conditions as stated with respect to Exhibit 133 and 134, except that in

—7,191—

this case, that is, in the case of Exhibit 135, there are figures derived by the secretary from the basic figures reported to him and tabulated in Exhibits 133 and 134.

Q. Is this also a monthly report? A. That is correct.

Q. And is this a fairly typical example? A. It is.

Mr. Browning: I offer it in evidence as Respondents' Exhibit 135.

9186

Mr. Binford: I would like to ask a question or two with regard to this exhibit.

The Examiner: All right.

By Mr. Binford:

Q. How long has this been a monthly report, Mr. Doolittle? A. Since substantially the beginning of the committees in 1921. I can't state positively just when it was begun in this form, but it is certainly of fifteen years standing.

F. W. Doolittle—By Respondents—Direct

9187

Q. Then for at least fifteen years reports of this character in substantially the form shown by the proffered exhibit have been prepared and distributed monthly? A. Yes. That is correct.

Mr. Binford: I object to the proffered exhibit upon the same grounds as stated with reference to the last five preceding exhibits.

—7,192—

The Examiner: This last-mentioned exhibit is admitted under the number mentioned.

9188

Mr. Binford: I respectfully except.

(The document referred to was received in evidence and marked "Respondents' Exhibit 135.")

By Mr. Browning:

Q. Mr. Doolittle, I hand you another form of statistical report entitled "Station Advisory Operating Committee—Yearly Weighted Average Performance Data—Steam Generating System—Year 1940." Is this another statistical report interchanged through the Station Advisory Operating Committee? A. That is correct. This tabulation is made annually by the secretary of the Station Advisory Operating Committee from data furnished him currently during the calendar year; and upon its completion it is circulated to the members of the committee and to the North American Company.

9189

Q. Is this a report that has been circulated for many years? A. I am not sure how long this annual summary in this form has been circulated. I am familiar with it for a

9190

F. W. Doolittle—By Respondents—Direct

number of years in this or substantially similar form. It is my recollection that it is not so old in continuous submission as the basic efficiency tables prepared monthly and circulated monthly to the operating companies.

Q. At any rate, it has been circulated for a number of
—7,193—

years? A. Yes.

Q. Is this particular example a fairly typical one? A. Yes.

9191

Mr. Browning: I offer it in evidence as Respondents' Exhibit 136.

Mr. Binford: Same objection upon the same grounds as noted to the last exhibit.

The Examiner: I make the same ruling and receive it as Respondents' Exhibit 136.

Mr. Binford: I respectfully except.

(The document referred to was received in evidence and marked "Respondents' Exhibit 136.")

9192 *By Mr. Browning:*

Q. I hand you another table, Mr. Doolittle, entitled "Station Advisory Operating Committee—Analysis of Coal Samples Submitted by Cleveland—January 10, 1941." Will you explain for us what this table is? A. In determining the thermal efficiency of a power plant the accuracy of the measurement of the British Thermal Units in the coal as fired is, of course, of fundamental importance. The same sample submitted to a number of different chemists will be reported by them as having slightly different value in terms

of B. t. u.'s per pound due to the difficulties of precise measurement of temperature rise in the calorimeter where

—7,194—

the coal is tested.

Each month one of the five companies represented by column headings in this exhibit marked "137" sends a sample of coal to each of the other companies as well as to its own chemist. Each then independently tests the coals and sends the result back to the secretary of the Station Advisory Operating Committee, who thereupon compiles the data as reported in this Exhibit 137.

9194

In this particular case it will be observed that the sample which the Cleveland chemist tested at 13,920 B. t. u.'s per pound dry was tested by Detroit at 13,930 B. t. u.'s per pound dry, by the Milwaukee chemist at 13,940, the St. Louis chemist at 13,900, and Washington at 13,920.

Incidentally, the maximum variation there is 20 B. t. u.'s out of a total of 14,000, which shows very close agreement. I cannot say positively, but it is my recollection that the Bureau of Mines accepts coal tests as accurate which run within 50, which would be more than twice the variation shown here.

9195

I might add also that in the beginning, when these sheets were first made up, and before the different chemists had developed a greater uniformity of technique, these variations ran substantially higher. While I haven't examined these very many times in the last five years, I am also under the impression that the variations shown here are perhaps a little bit better than the average practice gotten in this group

—7,195—

9196

F. W. Doolittle—By Respondents—Direct

of companies. I think maybe 30 B.t. u.'s would be a fair average variation.

The February sampling was done by another company and the December one by another company, and similar reports made up for comparison. So about twice a year it gets around to each company, and each chemist is put on the spot.

Q. Do I understand correctly, then, that this report is a typical example of the form of reports interchanged? A. Yes.

9197

Mr. Browning: I offer it in evidence as Respondents' Exhibit 137.

Mr. Binford: I would like to ask a question or two about it.

The Examiner: All right.

By Mr. Binford.

Q. What are the meanings of the initials "J. M. G. : E. S." in the lower left-hand corner of this exhibit? A. I suspect that the "J. M. G." are the initials of Mr. Gerber, who is the secretary of the committee. The "E. S." is probably his stenographer. The "13" I don't know. It probably represents the number of copies.

9198

Mr. Binford: I object to the proffered exhibit on the same grounds as those stated with respect to the reception of the last exhibits.

—7,196—

The Examiner: I receive it as Respondents' Exhibit 137.

Mr. Binford: Exception.

(The exhibit referred to was received in evidence and marked "Respondents' Exhibit No. 137.")

By Mr. Browning:

Q. Mr. Doolittle, I hand you a tabulation of statistical data entitled: "Intercompany Electrical Committee—Comparative Data on Circuit Interruptions and Equipment Failures." Is this a report which is circulated among the constituent companies through the Intercompany Electrical Committee? A. Yes.

Q. Do you know how long this report has been in circulation or a report in some such form? A. I cannot state with any degree of positiveness just how long this has been going. The data in this particular compilation goes back to February, 1937, the figures being for 12 months, running for the first 12-month period, ending in January, 1938. So the initial information goes back to February, 1937. That makes it about four years. But it is my impression that this has been going on since about 1930 in this form, although I cannot state that with any degree of positiveness.

9200

Q. It is a form of report currently circulated? A. Oh, yes.

Q. And is this a fair example of such reports? A. Yes.

—7,197—

9201

Q. Is this an annual report? A. No. This is a monthly report.

Mr. Browning: I offer it in evidence as Respondents' Exhibit 138.

Mr. Binford: Same objection as made to the last previous exhibit on the same grounds.

The Examiner: This exhibit, consisting of 22 blueprint pages, is admitted under the number mentioned.

Mr. Binford: I respectfully except.

9202

P. W. Doolittle—By Respondents—Direct

(The exhibit referred to was received in evidence and marked "Respondents' Exhibit 138.")

By Mr. Browning:

Q. Mr. Doolittle, I hand you another set of statistical tables consisting of five sheets entitled "Analysis of Electrical Losses and Efficiencies, Calendar Year, 1939." Is this another set of statistics currently exchanged through the Intercompany Electrical Committee? A. Yes.

9203

Q. Is this an annual report? A. Yes.

Q. Could you tell us whether this has been exchanged over the years? A. The substance of this report has been exchanged for practically since the inception of the committee. I think the form has been modified somewhat.

—7,198—

You will note that it deals step by step with the electrical efficiencies beginning with the net system output, carrying down the losses through transmission, conversion, transformation, distribution, to the total system, followed by a summary which carries the basic figures back to 1928.

9204

This would suggest to me that this particular type of comparison has been running now about fourteen years, because the initial date here is 1928. But in slightly different form but not wholly comparable it undoubtedly was compiled from the very inception of the committee, because it goes to the final answer of your distribution and transmission system efficiency.

Q. Is this report typical of the practice that has been followed for a number of years, at any rate since 1928? A. Yes.

F. W. Doolittle—By Respondents—Direct

9205

Mr. Browning: I offer the report in evidence as Respondents' Exhibit 139.

Mr. Binford: Same objection as that interposed to the last exhibit, on the same grounds.

The Examiner: This exhibit, consisting of four pages and the title sheet, five in all, is admitted under the number mentioned.

—7,199—

Mr. Binford: Exception.

(The document referred to was received in evidence and marked "Respondents' Exhibit 139.") 9206

By Mr. Browning:

Q. Mr. Doolittle, are these statistics so interchanged among the companies, of value? A. Yes. They are of very great value.

In the first place, they point directly to the strength and weaknesses of the practices of the various engineers and put them on notice before their fellow engineers. It is a distinct stimulus to an engineer to have comparable unbiased and fully revealing figures available to the men under him on his own staff; and I am satisfied that the availability of these figures over the years has contributed substantially to the excellent performance that the production departments of the companies, as well as the distribution departments, have obtained. 9207

The Examiner: At this point we will recess until tomorrow at 10 o'clock.

(Thereupon, at 5 o'clock p. m., an adjournment was taken until the next day, Thursday, April 10, 1941, at 10 o'clock a. m.)

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3070

9208

BEFORE THE

Securities and Exchange Commission

File No. 59-10

IN THE MATTER

of

THE NORTH AMERICAN COMPANY, *et al.*

9209

Hearing Room 1101,
Securities and Exchange Commission
Building,
18th and Pennsylvania Avenue, N. W.,
Washington, D. C.,
Thursday, April 10, 1941.

Met, pursuant to adjournment, at 10:00 o'clock, a. m.

9210

Before: WILLIAM W. SWIFT, *Trial Examiner.*

Appearances:

S. PEARCE BROWNING, JR., and CHARLES S. HAMILTON,
JR., of Sullivan & Cromwell, 48 Wall Street, New
York, New York, appearing for The North American
Company, *et al.*, Respondents.

RALPH C. BINFORD, appearing for the Securities and Ex-
change Commission.

F. W. Doolittle—By Respondents—Direct

9211

PROCEEDINGS

The Examiner: The hearing will come to order.

Whereupon, F. W. DOOLITTLE, a witness produced on behalf of the Respondents, having been previously sworn, resumed the stand and testified as follows:

Direct Examination by Mr. Browning (Continued):

Q. You testified yesterday, Mr. Doolittle, with respect to certain statistical information exchanged about the operating companies through the medium of the Station Advisory Operating Committee and Intercompany Electrical Committee, and identified various examples of statistical sheets so interchanged. 9212

Could this statistical information be secured by the operating companies in any other way? A. No. It is information compiled from original records on a somewhat different basis than any data of that sort formally reported to commissions, but portions of it, of course, are available in reports to commissions, but on the whole, no such consistent body of statistics and cost analyses are available. 9213

Then, of course, there is always the problem of interpretation of the Uniform Classification of Accounts in different jurisdictions and by different bodies, as a result of which varying technical practices in accounting and statistical

—7,202—

work grew up in the different jurisdictions. These, of course, do not affect the validity of the balance sheets and income accounts, but would make extremely difficult the functional

9214

F. W. Doofittle—By Respondents—Direct

cost studies which the members of the Committee made in behalf of their companies, as was indicated yesterday in regard to the Station Advisory Operating Committee and the Intercompany Electrical Committee.

Q. Are you familiar with the combined operation of the various businesses, by various subsidiaries in The North American Company System? A. Yes.

Q. For example, are you familiar with the operations of the electric, gas and transportation business in the Wisconsin Group? A. Yes.

Q. Have you any experience with State regulation of public utilities? A. Yes. I have been on the staff of two Commissions, the Wisconsin Commission and the Illinois Commission, and I have also appeared before various other State Commissions, representing utility companies.

Q. Does the combined operation of several businesses such as the example I mentioned in any way create any problem for State regulation? A. Yes. It creates problems both for regulation and operation, but problems no different

—7,203—

9216 in kind, and, in my judgment, even less in a degree than the problem which arises from joint serving of domestic, industrial and commercial customers in the electric business from the same generating plant.

So far as I know, no one has yet evolved a theory of peak load responsibility which has achieved anything like general acceptance. That problem is inherent in the use by different classes of customers of the same facilities, such as a generating plant. The problems arising from the joint operation of railway, gas, electric, for example, or the freight and pas-

F. W. Doolittle—By Respondents—Direct

9217

senger business of a steam railroad are problems of the same kind,—that is, the assignment to several services of their fair portion of the properties jointly used and similarly, the assignment to the costs of operation incurred in the interest of more than one service; for example, the maintenance of the railroad track over which both freight and passenger trains run.

The use of a general office building, in which the affairs of more than one type of service are administered, be they different classes of electric service or gas and electricity.

9218

The problems are inherent in the diversity of the contribution of the cost of the several customers to the total cost of the company, and not to the fact that one customer may receive electric service and another, gas service.

—7,204—

Q. In other words, if I understand you correctly, while the combination of businesses may create problems, they are essentially the type of problems which it is a commission's business to regulate? A. That is correct.

Q. And that there is no particular difficulty inherent in this type of problem? A. No, and no more difficulty in connection with this joint business than would be in connection with the problem of rendering a single type of service such as the electric or gas.

9219

Q. In other words, to avoid any problem, you should have one generating plant, one transmission line and one customer? A. That would relieve us of many of the problems.

Q. And then you would not need any commissions? A. No, and no managers either.

9220

F. W. Doolittle—By Respondents—Direct

Q. Are your view in this connection,—they would apply to other examples of combined businesses in The North American system such as, for example, the St. Louis County Gas Company in the Union Group? A. Yes. A good illustration is a steam heating and electric service in other places such as Cleveland, where there is a joint use. The Missouri Company happens to be separately incorporated.

Q. So that a combination of businesses doesn't impair the State regulation? A. I don't think it does.

9221

—7,205—

Q. Mr. Doolittle, can you explain for us the function of the holding company in operating matters under the North American scheme of operation? A. Well, the North American scheme, ever since I have been associated in any way with the holding company, or its subsidiaries, has had for its major objective the development of as skillful an operating organization as it was possible to get.

9222

Q. Operating organization where? A. On the operating properties, and to maintain no operating organization by the holding company, itself. That is, the North American organization never tempted to supplant the operating organization of the holding company.

Q. Of the what? A. Of the local management, I should say, but to supplement the skills of the operating company's management by what might be termed a consultative process. The utility industry has certainly not been static, particularly the electric business has shown very great changes, very great developments over the last twenty-five years and so far as I can see, there is no present tendency to end the development. That means that in such a dynamic industry, as com-

pared with one more static, there is a constant change and unless such change is recognized, an operating company tends to become stagnant.

—7,206—

There is no opportunity for local comparison. A dry goods store or a grocery store is stimulated by its contacts with other men and other industries of a like nature in a community, but the operator of a power plant of a utility company, for example, has no local means of keeping himself up to date and stimulated such as these other industries of which there are likely to be several in any community. 9224

A considerable part of my duties for a number of years was to discuss both in New York and on the operating company's property, with the operating heads and engineers of those departments, new aspects of old problems and new problems which arose, and to help those men reach sound conclusions. After all they were their conclusions when reached; they were not mine.

We are dealing here, partly, with technical matters but we are also dealing with people; and it is a rather delicate situation, nonetheless, one of fundamental importance and of greatest value to avoid operating a man's property for him and at the same time, to give him the maximum stimulus and help in reaching a sound conclusion; because, unless when these conclusions are reached, they are his and he really believes them, you are not going to get maximum performance in the carrying out of the plans developed. 9225

I might perhaps elaborate on this but I think that is the nub of the matter that The North American Company believes in the highest possible technical skill on the part of

—7,207—

9226

F. W. Doolittle—By Respondents—Direct

its management, it believes in furnishing those men with such consultation, both on their properties and in the New York office as will keep those men thinking clearly, keep them abreast of the times, and enable those operating men to reach, for themselves, the conclusions which are the wisest.

I think it is fair to say that in many instances, the opportunity of the head of an operating utility to discuss his problems with a sympathetic and, I hope, a reasonably well informed person who has the financial interests of the operating company at heart, is of greatest value.

9227

Q. It was this theory of the function of the holding company that resulted in the organization of The North American Company, itself? A. That is true. The North American organization consisted of men of experience and judgment, with such a staff of a statistical and secretarial nature that the North American officers could keep themselves informed as to developments, tendencies in costs and performance on the various properties, but without such that there would be a temptation to actually design a boiler or a power house which, after all, eventually had to be operated by the man on the property and not by the North American staff.

9228

Q. If I understand you correctly, the theory was, in effect, that the heads of the respective operating companies

—7,208—

managed their properties and the function of the North American executives was to consult and advise with them?

A. That is correct.

Q. In carrying out this theory, did you talk to the heads of the properties? A. Very frequently.

Q. For many hours? A. Yes, for days at a time, both in New York, Cleveland, St. Louis, Milwaukee, Washington, and so on.

Q. Could you give us any example of the way the process works? A. Well, one matter that arose some years ago had to do with the expansion of the Cleveland territory beyond the Cleveland corporate limits. The advent of roads, the building up of suburban properties adjacent to Cleveland, and other forces, tended to make that territory along the south shore of Lake Erie, from the Pennsylvania line practically all the way across the State, much more homogeneous than it had been. The President of the Cleveland Company, at that time, had been many years in Cleveland and he had rather fixed ideas that the Cleveland Electric Illuminating Company should serve approximately the City of Cleveland and the adjacent suburbs.

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I had some conversations with the President of that Company, at that time.

—7,209—

Q. That was Mr. Lindsay? A. Mr. Robert Lindsay. I participated in the discussions in which Mr. Gruhl, an officer of The North American Company, also participated, and I have no doubt that there were discussions on this matter in which I did not participate, but in any event, it was our judgment, in New York, that the territory which should have the Cleveland service was no longer the immediate vicinity, —the City of Cleveland and its immediate environs, but a substantially greater area, which, by that time, was practically as much a part of the City of Cleveland as one of the nearer suburbs had been ten or fifteen years before.

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9232

F. W. Doolittle—By Respondent's—Direct

Eventually, Mr. Lindsay reached the same conclusion and at that time certain properties lying between Cleveland and Ashtabula were integrated with the Cleveland system, power sources established in the newly acquired area, and the whole area is now, from a service and rate standpoint, a single area.

9233

That is typical of the kind of thing under discussion, I, myself, had a number of discussions, running over a considerable period of time, with the President of the Potomac Electric Power Company with respect to the form of rates that that Company should adopt.

It had been a Mr. Ham's theory that a flat rate of so many cents per kilowatt hour, without regard to quantity, had in the past met the needs of Washington and would likely continue to be a satisfactory scheme.

—7,210—

9234

I felt rather strongly on the matter that the incentive type of rate was important; Mr. Gruhl did, also, and eventually Mr. Ham decided to retain, I believe, Stone & Webster, to make a report on the rate situation. Following that, Mr. Ham concluded that a promotional form of rate would, in the long run, serve the community, and the Company, better than the flat rate system.

A slightly different sort of a situation arose prior to my becoming an officer of The North American Company. When I was retained by one of the subsidiaries and I had a problem, with respect to certain valuation and rate cases in which I, at the suggestion of the head of the company for which I was working, came to New York to discuss the matter with Mr. Gruhl who, prior to that time, had had a great deal of experience in Wisconsin and Missouri and had for a number

of years, been a member of the staff of the Wisconsin Commission. I did that and received the suggestions and advice but ultimately Mr. Way and I had to make up our minds as to what we were to do.

My reason for mentioning that was that at other times I had been engaged by the Chicago Elevated Railway Company to go before the Illinois Commission in substantially the same sort of case, that is, valuation and rate proceeding and there was no holding company and no financial interest back of that that I could go to. We worked out our problems as best we could and I think we did a good job but I would

—7,211—

have greatly appreciated the help Mr. Gruhl might have given us in the Chicago Elevated case.

Q. Are matters of the type you mentioned such as the development of the Cleveland Company's territory and the change in the Washington rate schedule important matters to those operating companies, and a very important question, have the companies and the public benefited from the adoption of the views which The North American Company officers advocated? A. Certainly the service and rates in Cleveland Electric Illuminating territory represented a distinct advantage to their customers and I think the expansion of territory has made the financial status of the Cleveland Company, through greater diversification, better than it would have been had it confined itself to the narrow limits of the City of Cleveland.

As to the rate situation, in Washington, I am sure that the promotional form of rate which has increased the use per customer so markedly, has resulted in lower costs and constantly lower rates, forming an element of value to the

9238

F. W. Doolittle—By Respondents—Cross

community that is well-recognized, certainly in the industry, and among those connected with the company, and I feel that it is safe to say that it is generally appreciated in the community.

Q. This consultative process which you discussed is
—7,212—

something which goes on more or less constantly? A. Yes, with different companies and different problems on different days, but it is constantly going on.

9239

Q. Is such a consultative process a source of value to the operating companies? A. I am sure it is. As I say, I availed myself of this when I was working for the Milwaukee Company, the result of operations of these different companies have been so outstanding and all point to this conclusion and I am satisfied, myself, that it is of great value to the companies.

Q. Do you consider that a common financial interest is essential to the process? A. Yes.

Mr. Browning: That is all.

9240

Cross Examination by Mr. Binford:

Q. Mr. Doolittle, you spoke yesterday of the Inter-company Electric Committee of the North American system? A. Yes.

Q. Who is the Secretary of that Committee? A. Mr. Gerber. Mr. Gerber, of Cleveland.

Q. Is Mr. Gerber also Secretary of the Station Advisory Committee? A. Yes.

Q. That is, I believe it is known as the Station Advisory

—7,213—

Operating Committee? A. Right.

Q. Where is Mr. Gerber's office? A. Cleveland, with the Cleveland Electric Illuminating Company.

Q. Does Mr. Gerber receive a salary or compensation for his work in connection with the two committees you have named? A. Yes.

Q. From whom does he receive such a salary or compensation? A. I can't speak from the record today, but originally, and I assume today, his salary is divided between the participating companies, that is, the companies which have membership on these two committees.

9242

Q. Does he devote his entire time to the work of these two committees or the work incident to their functioning? A. I can't answer that, but I think he has no other important duties.

Q. Does he draw compensation for the performance or the discharge of duties other than for system committees? A. I think not.

Q. How are the expenses incident to Mr. Gerber's work for these committees paid, such as the expenses incident to the compilation and distribution of the reports and other

9243

—7,214—

data which are interchanged? A. I can't answer that question.

Q. Is Mr. Gerber an engineer? A. I think he had engineering training; I am sure he had statistical training, but he is not otherwise engaged in engineering work than the work of these committees.

Q. Has he been secretary of these committees since their inception? A. Since quite early, I believe there were one or

9244

F. W. Doolittle—By Respondents—Cross

two short term secretaries that preceded him, but it is substantially true that he has been secretary of these two committees for most of their twenty years of existence.

Q. I believe you stated that in 1936 you retired, as an officer of The North American Company, but you have continued as a director of that company? A. Yes.

Q. And are presently a director? A. That is true.

Q. Are you retained in a consulting capacity by The North American Company at the present time? A. Yes.

9245

Q. And you receive compensation for your activity in this respect? A. Yes.

Q. What proportion of your time, since 1936, have you —7,215—

usually spent on the affairs of The North American Company? A. That would be extremely difficult for me to estimate. Normally, when I am at home, at Garden City, I am in the office perhaps twice a week,—that doesn't mean that I go in and do a day's work at a desk twice a week, but that I meet the officers and discuss various matters with them. A considerable part of the time, however, I am away from New York and at other times, such as this, I may be continuously engaged for several days or perhaps several weeks on some particular matter.

9246

I am afraid I would be unable to estimate the percentage of my time devoted to The North American Company any more accurately than that.

Q. Prior to your retirement as an officer in 1936, you devoted your entire business time to the activities of The North American Company? A. Yes, that is correct.

Q. I believe you heard a part of Mr. Freeman's testimony yesterday and today? A. Yes, I heard a portion of it.

F. W. Doolittle—By Respondents—Cross

9247

Q. I think Mr. Freeman gave the names of the members of the Board of Directors of The North American Company, who were also compensated officers or employees of subsidiary companies of the system.

Since you are a member of the Board of the North American I suppose you know what members of that Board are paid officers or employees of The North American Company?

—7,216—

A. Yes.

Q. Will you please state their names.

9248

Mr. Browning: (Off the record).

The Witness: As I have stated, I am a director of The North American Company and am on retainer; Mr. Fogarty is Chairman of the Executive and Finance Committee, a paid officer of The North American Company; also, Mr. Freeman, Mr. Moody, Mr. Piske, Mr. Shea, and Mr. Williams.

By Mr. Binford:

Q. Now, that leaves how many members of the Board of Directors of The North American Company who are not paid officers or employees of The North American Company or of a subsidiary company thereof? A. Only Mr. Murnane.

9249

Q. What is Mr. Murnane's occupation, other than a Director of The North American Company? A. He is engaged in the investment business.

Q. Upon his own account or as a member of a firm, or otherwise? A. I can't answer that, he has associates, and whether they are a firm or what their relationship is, I don't recall. I would have to refresh my memory.

9250

F. W. Doolittle—By Respondents—Cross

Q. But his associates, so far as you know, are not otherwise connected with The North American Company? A. No.

—7,217—

Q. Nor any of their affiliates? A. No. I don't know them.

Q. Is there representation upon the Board of the preferred shareholders of The North American Company? A. Yes. I am a Director elected by the proxies of the preferred shareholders.

Q. You are? A. Yes.

9251

Q. And who are the others so elected? A. Let the answer show that I do not know.

Q. How long did you say you had been a Director of The North American Company? A. Since 1925.

Q. There was no representation of the preferred stock on the Board of The American Company until a time subsequent to January 1939, was there? A. Relatively a recent date, I can't state that it was first after the 1939 meeting, but it was not far from that.

Q. So, prior to 1939, you were elected by the vote of the common stockholders? A. That is true.

9252

Q. And you said that you do not know who the other representatives of the preferred stockholders are? A. I am not sure which of the other directors are the other so-called preferred stock directors.

—7,218—

Q. Then, you can't state whether there was any change in the personnel of the Board of Directors of The North American Company as the result of the amendment of the charter of that company in 1939 which purported to give representation upon the Board to the preferred shareholders?

A. I don't recall what changes were made at the 1939 meeting, and I am not able from memory, therefore to say whether there was any change in the composition of the Board at that time and if so, for what reason.

Q. Were any Directors elected in the year 1940? A. Yes. There are one-third of the Directors elected at each annual meeting.

Q. Did you designate, by yourself or in consultation with anyone else, the names of persons who were to be nominated for the Board of Directors as representatives of the preferred stock in 1940? A. The question of Board membership has become one of increasing difficulty in recent years. We have lost counsel from our Board, we have lost bankers from our Board, we have suffered through death, loss of the older men of the organization, and in each case we have found difficulty in securing men of background and experience and I think it is safe to say that the problem of getting competent men,—I know in my own case that has been the uppermost problem,—whether that man was designated a nominee of the preferred stock or of the common stock. I, myself, personally, have been in my small way, a considerable more of a preferred stockholder than a common stockholder and I assume that was one of the reasons for my appearing as a nominee for election by preferred stock proxies. Probably the proxy statement sent out would throw additional light on this subject.

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In view of the holding of stock by the directors, I can't say that positively, but I think so.

Q. I don't believe that you answered my question fully.

The Witness: Will the reporter please read the question?

9256.

F. W. Doolittle—By Respondents—Cross.

(Whereupon, the pending question was read by the reporter.)

The Witness: No, I can't recall that I had any part in any such designation.

9257

Q. Who selects the nominees, or who did in 1940, as representatives of preferred stock and as representatives of common stock on the Board. A. As a practical matter, the officers and directors canvass the situation among themselves, as the Committee of the Whole, and out of their discussions come suggestions that certain people be asked if they will stand for election. I cannot be more specific than that.

9258

Q. I presume that discussion, up to the point of the canvass, takes place in New York and among the officers and

—7,220—

directors located in New York, primarily, isn't that right?

A. Undoubtedly most of such discussions take place in New York and the officers and directors who live in New York are most likely to be present at any discussion, but the directors who live elsewhere are often in New York and on such occasions participate, of course, in the discussions.

Q. You were retained in a consulting capacity by The North American Company.

Just what are your duties in this connection? A. Hold myself available for consultation with officers of the company on such problems as they care to discuss with me.

Q. Those problems are primarily of an engineering and operating nature, are they? A. Yes. Rate matters, which of course are a part of operations,—there is rarely any dis-

cussion with me as a director on matters of finance. Those questions won't normally be discussed with me. The question of value of properties, as operating entities, their earning power, their probable future, I have spent some time, a good deal of time, in the past four and one-half years in considering, on the basis of trips through the territories, the reports of the companies, their probable possibilities for future growth, the strength and weaknesses of properties, both of those whose securities are in the portfolio of North American and other contiguous properties, or properties in other

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—7,221—

parts of the country, so while I eliminated from the matters which I would be likely to discuss, or which would be discussed with me, questions of finance, etc., I want specifically to include the questions of values of securities based on their possible productivity.

Q. Your acquaintance with the day to day operation of the system properties and The North American Company has, of course, been less intimate since your retirement as an officer in 1936? A. Correct.

Q. Than it was theretofore? A. That is correct.

9261

Q. At the time of the first investment by The North American Company in North American Light & Power Company, you were active in the affairs of The North American Company? A. Yes.

Q. And I presume you made some investigation as to the underlying values of the operating properties involved in this investment? A. I was junior officer, lately come to the company then, and I, myself, made no field examination of the properties.

9262

F. W. Doolittle—By Respondents—Cross

Knowing the general territory being served, I was in, of course, on some of the discussions.

Q. What position did you occupy with The North American Company when The North American Company became

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the dominant investor in North American Light & Power Company?

Mr. Browning: Will counsel define what he means by giving the year? Do you mean the year 1932?

9263

Mr. Binford: I am speaking of 1932.

The Witness: I was a vice president of The North American Company at that time.

By Mr. Binford:

Q. At that time, did you make an investigation into the status of those properties from any point of view of The North American Company? A. You referred to 1932 at which time The North American Company—

9264

Q. (Interposing) It has been stated that the Insull interests failed to live up to a certain contract which they had entered into in respect to North American Light & Power Company stock issues, and The North American Company, pursuant to its obligation under such contract became the holder of more stock than anyone in respect to common stock.

A. Subsequent to that occasion that you mentioned, I spent more time in Chicago and on the property of North American Light & Power Company than before because at the time The North American Company became increasingly responsible for the future of that situation, but I made no examination

of or report on the physical property of North American

—7,223—

Light & Power Company in 1932, in specific answer to your question.

Q. Nor at any subsequent time? A. From 1932 on to 1936, I was on all the physical properties, from time to time, that is the physical properties of the subsidiaries of North American Light & Power Company and was in frequent touch with the operating men so that from that time on, my contacts with their operations were more detailed than they had been theretofore.

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Q. Prior to 1932, was the management and supervision of the operating properties comprised within the North American Light & Power Company system left, by the North American Company, largely to Middle West Utility Company? A. The management of North American Light & Power Company was entrusted to the Board of that company on which there was equal representation of the North American Company, and Middle West, together with an advisory committee composed of, I believe, two operating men from North American properties and two from the Insull properties. The offices of the North American Light & Power Company were in Chicago, the offices of the Middle West Company were in Chicago, and the offices of the North American Company were in New York.

9267

Q. When you refer to "Insull" and "Insull Interests", you are referring to Middle West Company and affiliates, is that right? A. That is true. Under their geographical situation, I think it is safe to say that the management of North

9268

F. W. Doolittle—By Respondents—Cross

American Light & Power Company had more frequent and more intimate contact with and access to the Middle West group than it had to the North American group whose offices were located in New York.

Q. As a matter of fact, isn't it true that the Middle West holding company organization supervised the activity of the operating companies of North American Light & Power Company in very much greater detail than was the practice of the North American Company with respect to its direct

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—7,225—

operating subsidiaries?

The Witness: Read that back, please.

(Whereupon, the pending question was read by the reporter.)

The Witness: No, I don't think so; except as I have explained, incidental to the geographical location there were more frequent and more intimate contacts, but so far as I know there was no more of a formal attempt to manage on the part of Middle West than there was on the part of North American Company.

9270

By Mr. Binford:

Q. You are presently an officer of Illinois Terminal Railroad Company? A. Yes—no, I am a director.

Q. Would you say that there has been an improvement in the financial and physical condition of the operation properties of the North American Light & Power Company group since 1932? A. On the whole—yes.

F. W. Doolittle—By Respondents—Cross

9271

Q. And how would you say that had been effected,—what would you consider as among the principal factors in that change? A. In the first place, immediately after 1932, Mr. Fogarty, vice president of the North American Company began to devote a substantial part of his time to the financial problems of the North American Light & Power Company group of properties and also to the problem of operating personnel.

—7,226—

As the result, a rather large office force in Chicago which had rendered management services under contract to the North American Light & Power Company and subsidiaries was gradually eliminated. The problems of management were placed back on the operating heads of the companies and they were given advice and consultation after the pattern that had been used by the North American Company.

9272

Following the improvement of the financial situation and improved credit of companies such as Kansas Power and Light, the problems incident to the integration of that property out of a number of predecessors were cleared up. As the result of these and other similar things, the condition of these properties, physically,—their financial set-up and so on, has been steadily improved.

9273

Q. In taking over control and supervision of the North American Light & Power Company, did you notice any great advantages that had been achieved, or obtained by the operating companies of that system which you directly attributed to the holding company management which it had enjoyed before? A. Well, I was not familiar with the properties before they were assembled by the Studebaker group in 1920, or thereabouts, and I would have little means of judging what

9274

F. W. Doolittle—By Respondents—Cross

change had come about or what progress had been made up to the date we are using to define North American Company's more active participation,—that is, 1932.

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Q. But, as you have outlined, The North American Company management felt it desirable and acted upon that feeling to reform the existing organization, somewhat? A. Yes, the form of it was changed to more nearly conform to the practices and policies of the North American Company in dealing with its associated companies, operating companies.

Q. Was the practice of having certain of the heads of operating companies upon the Board of Directors of North American Light & Power Company, in order that the advantage of their advice and consultation might be received, continued as it had been theretofore? A. I would have to refresh my memory on the membership of The North American Light & Power Company Boards; I can't answer that question from memory.

9276

Q. Well, that practice has been subsequently adopted in the case of The North American Company's Board, itself, hasn't it? A. At the moment, it is very evident in the composition of the Board of Directors of the North American Company. In years past, operating heads of subsidiary companies have been members of the Board, I don't recall any time in which a larger proportion of the operating heads were members of the Board than now, unless it is prior to 1920; when I think the president of the Milwaukee Company and president of the St. Louis Company were each members of the North American Board, in which case there was 100

—7,228—

per cent. representation on the Board. It fluctuates, as a practice, but it is a good practice in my opinion.

Q. One purpose served, I presume, by such inclusion of officers of operating companies upon the Board of the parent is that the directors have at their meetings sources of first-hand information as to operations which would not be otherwise available? A. That is true, and on general business, industrial and economic conditions in the territories served by those operating subsidiaries.

—7,229—

9278

Q. Do you have any knowledge of the extent of the supervision of The North American Company over its subsidiaries in respect to their public relations,—by which I mean, their dealings, in this instance, with public boards, regulatory bodies, and their opposition to or sponsorship of legislation affecting their interest? A. Any matters affecting, in the judgment of The North American Company officers, the permanence of the value of the investment or earning power of the subsidiaries is a matter which would be discussed with the men operating that property and under that heading would come various trends,—trends in economic and in social thought in the various communities,—

9279

Mr. Binford: (Interposing) Mr. Examiner, I have been called before the Commission on another case and I wonder if we could have a fifteen minute recess?

The Examiner: All right, we will recess for fifteen minutes.

(Whereupon, following the taking of a fifteen minute recess, the hearing was resumed.)

9280

F. W. Doolittle—By Respondents—Cross

Mr. Binford: Will the reporter repeat the last question?

(Whereupon, the question asked by counsel immediately prior to the taking of the recess was read by the reporter.)

Mr. Browning: Had you completed your answer, Mr. Doolittle?

The Witness: No, I do not think so.

9281

Mr. Browning: Well, complete it at this time.

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The Witness: (Continuing) —and legislations growing out of such trends.

By Mr. Binford:

9282

Q. Are you familiar with the fact that there is a suit presently pending in St. Charles County, Missouri, wherein relief is being sought, in part, by forfeiture of the charter of the Union Electric Company of Missouri, and of the right of that company to continue to do electric utility business within the State of Missouri? A. I am advised that an action of that sort has been brought.

Q. Do you know the grounds asserted as the basis for the relief sought in that suit? A. I can't express them in legal terms, but it is my understanding that the allegations made were, of improper influence of Governmental process.

Q. Do you know any more particularly what Governmental process was supposed to be influenced, under the allegation? A. I am not familiar with the details of it.

Q. Does the Board of Directors of The North American Company make it its business to familiarize itself with such

instances as I have mentioned, of conflicts between local regulatory, or local prosecuting officers and its operating company? A. Yes, in the first instance, the officers', and the

—7,231—

reports are made to the Directors on these matters and questions are asked of the officers by the Directors. The Company does make an effort to inform itself on these matters.

Q. Do you know whether or not there have been other instances in the past few years of charges of improper conduct against officers, or former officers, of the Union Electric Company System in relation to alleged undue Governmental influence, or in that general field? A. Yes, there have been, and there have been certain changes in the operating personnel of the properties serving the St. Louis District as a result of those charges.

9284

Q. As a matter of fact, this Commission did some investigatory work on this general subject matter, did it not, in the Union Electric Company field? A. Yes.

Q. Were any facts brought to the knowledge of the Board of Directors of The North American Company as to practices along the line which I have suggested which it did not approve? A. Yes.

9285

Q. Have any similar practices of which the Board of Directors of North American Company did not approve been brought to the attention of that Board in respect to any other companies in the System within the past two or three years?

A. One other, and that is, as I recall, Illinois-Iowa Power

—7,232—

Company.

Q. As a matter of fact, in certain of these instances indictments have been entered, or returned, against certain

9286

Elmer L. Lindseth—By Respondents—Cross

persons, based upon activities alleged to have been engaged in by those individuals while they were connected with operating companies of The North American System, is that true?

A. That is true.

Q. The activities complained of in these various proceedings, or investigated therein, did not reach the attention of the Board of Directors of The North American Company, as far as you know, until Governmental investigation was begun? A. I think that is true.

9287

Q. To what do you attribute the fact that such incidents or such practices do occur and develop without reaching the attention of The North American Company's Board of Directors? A. The process of leaving the management to local officers and advising and consulting with them is, as I have said, a very delicate one because it involves personalities as well as, or as distinguished from, the physical materials in the engineering field.

In the particular cases which you mentioned, I can only say that the local management,—that the management became too completely localized.

9288

One of the most difficult problems in management is that of securing an assistant, or assistants, who, themselves,

—7,233—

assume a correct portion of responsibility.

In other words, a chief engineer who has an assistant under him finds that an assistant of most value does not run to the chief with every minor problem, nor, on the other hand, does not trust his own judgment on matters in which he is incompetent.

Now, those human relationships are in a delicate balance and my only answer is, that that management, over a certain

period of time, became too highly localized and was not acting on the consulting advice and suggestions of the officers of The North American Company.

Q. The North American Company, through the sponsorship of the Committees which you have mentioned, and otherwise, is of course highly interested in the efficient development and operation of the utility properties, I suppose, but I suppose it is likewise true that it is interested, to some extent, in the manner from a public welfare point of view, in which results are achieved as well as the results themselves? A. That is very true.

9290

Mr. Binford: I have no other questions of Mr. Doolittle at this time. However, I reserve the right to recall him for further examination if it appears advisable in the future course of the hearing.

Mr. Browning: As usual, we object to the reservation.

The Examiner: I will refrain, as usual, from ruling

—7,234—

until the occasion arises.

9291

Redirect Examination by Mr. Browning:

Q. Mr. Doolittle, when the facts regarding the Union situation, about which counsel has just asked you, were brought to the attention of the officers and Directors of The North American Company, did they immediately change the executive management of the Union Company? A. Those men were pulled out of their positions operating the properties that were under them.

9292

Elmer L. Lindseth—By Respondents—Direct

Q. And new executive management sent to St. Louis?

A. That is true.

Mr. Browning: That is all.

Mr. Binford: The same reservation.

Mr. Browning: I will recall Mr. Lindseth.

Whereupon, ELMER L. LINDSETH, a witness produced on behalf of the Respondents, having been previously sworn, resumed the stand and testified further as follows:

9293

Direct Examination by Mr. Browning:

Q. Mr. Lindseth, referring to Respondents' Exhibit No. 124, do you wish to add anything to your testimony with respect to Sheet "E" of that exhibit? A. Yes, I do. The

—7,235—

exhibit related to the comparative bills in communities of various size groups and for a range of average use per month of the companies in The North American System, as related to the average of all other companies in the State in which those systems operate.

9294

In describing this exhibit, I failed to mention and give adequate credit in the case of Wisconsin Electric Power Company to the fact that the average charge for electric energy is different from the bills, as computed from the rate schedules as filed, due to the operation of the plan which a previous witness for that company has described as the so-called "10-for-1" plan, under which users of electric energy receive that energy at a cost per month lower than the filed bills when they conform, or meet certain conditions specified in the plan.

Elmer L. Lindseth—By Respondents—Direct

9295

Specifically, a footnote should be added at the bottom of the exhibit as follows:

f—Without giving effect to "10 for 1" plan of Wisconsin Electric Power Company.

The footnote applies to four horizontal lines of data in the exhibit and the appropriate reference should appear at the following points in the table:

1. In the 4th line after the words "TNACo. present properties" under the caption "WISCONSIN-MICHIGAN SYSTEM".

9296

2. After the 8th line following the words "Average, combined TNACo. systems above" under the caption "ABOVE SYSTEMS COMBINED".

3. In the lower half of the table after "TNACo. present properties" following the caption "WISCONSIN-MICHIGAN SYSTEM".

4. In the last line of the table after the words "Average, combined TNACo. systems above" under the caption "ABOVE SYSTEMS COMBINED".

9297

The Examiner: The Sheet, as originally admitted in evidence, is amended in accordance with the witness's request; that is, Sheet "E" to Respondents' Exhibit No. 124.

By Mr. Browning:

Q. If I understand you correctly, Mr. Lindseth, the situation in substance, was that the comparison in this Sheet "E" was unfair to the Wisconsin properties of The North

9298

Elmer L. Lindseth—By Respondents—Direct

American Company System, since it utilized for those properties the nominal rate without giving effect to the substantial reductions therein, in actual practice under the "10 for 1" plan? A. Yes, that is so. Under the "10 for 1" plan, as has been described in this proceeding, reductions from the filed rates are given to consumers who meet certain requirements, the principal of which is an increased use in energy relative to that used in the previous year. The benefits of the plan are extended to users in several rate classifications and in communities of all sizes and this particular exhibit

—7,237—

relates to residential consumers in those communities.

The effect of the operation of the plan in 1938 was a saving to all residential consumers of more than \$728,000,—in 1939, the saving was more than \$685,000, and as a result, it is correct to say that the comparison as filed in Sheet "E" is less favorable to the combined North American properties in the Wisconsin-Michigan System than actually is the case, due to the fact that this very substantial saving to residential consumers was not included in the calculations.

9300

Q. Mr. Lindseth, I hand you a sheet containing four maps, entitled: "The North American Company Evolution of Electric Transmission in Certain Areas—Showing Lines of 26.4 kv. and Over, as of the Years Shown".

Were these maps prepared under your supervision and the data thereon taken from the records of the respective companies? A. Yes, sir; that is so.

Mr. Brewning: I offer this series of maps in evidence as Respondents' Exhibit No. 140.

Mr. Binford: No objection.

Colloquy

9301

The Examiner: Let the exhibit come in under that number.

(The document referred to was marked as Respondents' Exhibit No. 140 and received in evidence.)

—7,238—

Mr. Binford: May I ask a question or two in regard to this exhibit?

Mr. Browning: Certainly.

Mr. Binford: Are the transmission lines shown on Respondents' Exhibit No. 140 transmission lines owned by subsidiaries of The North American Company?

9302

The Witness: Well, subsidiaries as defined,—how? Not all these are so-called consolidated subsidiaries of The North American Company.

Mr. Binford: Well, are they all owned by companies within The North American holding company system?

9303

The Witness: With two exceptions,—yes; and in those two cases, rights over the lines for the transmission of energy are retained under lease.

The significance of those is shown in the north central portion of Illinois, the two lines shown "dotted" which have been described by a previous witness in this proceeding and which are owned by the Commonwealth Edison Company interests, but over which, by contract, the Illinois Iowa Power Company

9304

Elmer L. Lindseth—By Respondents—Direct

has rights for the transmission and delivery of energy; and a second case is that of the Central Illinois Light Company's transmission lines running from Peoria, Illinois, or a point just south of Peoria, Illinois, known as Junction "A", southward to a point on this transmission line known as Fancy Prairie, on which the Central Illinois Light Company has built, or rather, has installed conductors on towers which had been existing and those conductors have been leased to the Illinois-Iowa Power Company for their exclu-

9305

—7,239—

sive use. Title, in that case, probably resides in the Central Illinois Light Company, but the sole use is by the Illinois-Iowa Power Company.

Those are the only two exceptions.

Mr. Binford: That is all I wanted to ask, at this time.

By Mr. Browning:

9306

Q. I should like the witness to explain one further point on this exhibit:

The lines on this exhibit are the same, irrespective of their capacity, so long as they are over 26.4 kv., is that correct? A. Yes, that is correct.

Q. And during the periods shown by the respective maps, is it a fact that in addition to the building of new lines, that in many cases old lines were strengthened and made of higher voltage? A. That is emphatically the case. For example, in Kansas, in the territory of the now Kansas Power and Light, and which, in this series of maps, was

Elmer L. Lindseth—By Respondents—Direct

9307 ✓

the territory of predecessor companies merged into the Kansas Power and Light, many of the lines shown on this exhibit as transmission lines were first constructed at 33,000 volts. As the demand for energy increased,—and as the requirements of transmission became increasingly exacting,—those very lines were changed from 33,000 volts to 66,000 volts, in many cases, and changed from wood pole construc-

—7,240—

tion to steel towers. That is a characteristic of transmission line evolution, without apparently being indicated on the maps.

9308

At the present time, in the territory of Illinois-Iowa Power Company, transmission lines of 66,000 volts are being rebuilt to 132,000 volts. The map will, in this case, indicate no apparent change although the processes of evolution in transmission which are going on constantly are actually in operation.

The significance of these maps is very clearly one that an electric utility system is never in a static state, that neither perfection nor completion is ever reached, and as load demands and service demands increase, those demands are met by construction and rebuilding of existing lines, or the construction and building of new lines to meet those needs.

9309 ✓

A striking advance in the service to this territory represented on this map is demonstrated by this series.

Mr. Browning: Will you please mark as Respondents' Exhibit No. 141, for identification, this series of three sheets entitled: "The North American Company

9310

Elmer L. Lindseth—By Respondents—Direct

Comparison of Average Residential Monthly Bills in Cities of 50,000 Population (a) and More, Served by Privately Owned Electric Utilities".

Mr. Lindseth, from where did you obtain the data used in making up this exhibit?

A. These data, throughout, are obtained from a series of —7,241—

9311

Federal Power Commission reports entitled "Typical Electric Bills in Cities of 50,000 Population and More."

Q. And the exhibit was compiled under your supervision from data so obtained? A. Yes, it was; and by the methods which are used by the Federal Power Commission in the preparation of these specific data.

Q. The averages are shown for companies not subsidiaries of registered holding companies,—are all such companies privately owned in the country? A. Serving cities of 50,000 population and above,—yes.

9312

Mr. Browning: I offer these tables in evidence as Respondents' Exhibit No. 141.

Mr. Binford: Mr. Examiner, I do not wish to be in the position of admitting the relevance and materiality of these comparisons without more analysis than is shown supporting the validity of the comparisons.

However, I make no objection to the reception of this exhibit in evidence at this time.

The Examiner: Very well. It is admitted under the number mentioned.

(Respondents' Exhibit No. 141 received in evidence.)

Elmer L. Lindseth—By Respondents—Direct

9313

By Mr. Browning:

Q. Are you generally familiar, Mr. Lindseth, with the testimony offered in this case for the Respondents? A.

—7,242—

Within the definition of "generally familiar",—yes.

Q. Since the testimony has been offered with respect to the various operating companies, have any of them arranged to furnish electricity to customers beyond their service areas, as shown by the testimony heretofore introduced? A. Yes, that is the case.

9314

Q. Well, to complete the record here, will you tell us what are those cases? A. Under the very rapidly increasing loads incident to the execution of the Defense Program, it has become necessary, in a number of cases, for The North American Company subsidiaries, and properties in The North American's System, to extend its facilities to meet defense needs in territory usually not considered a part of the territory of these subsidiaries.

Specifically, for example, the United States Navy Department has very markedly increased the capacity and output of a Naval powder plant at Indian Head, Maryland, some thirty miles south of here, on the Potomac River, on the left bank.

9315

This plant, which has been in existence for some time, has heretofore been served with power, or received its power requirements from a power plant owned by the Navy Department there. However, because of engineering reasons, the capacity of their plant was not able to be increased and the Navy Department sought to purchase the necessary energy for increased requirements.

—7,243—

9316

Elmer L. Lindseth—By Respondents—Direct

The territory is served by a utility not a member of The North American Company System, which was quite unable to handle the very large requirement requested by the Navy, —7,000 kilowatts,—and the Navy Department approached, and entered into negotiations with the Potomac Electric Power Company for the construction of a transmission line from Washington, specifically from the Bennings Plant, to Indian Head, Maryland, a distance of about thirty miles.

9317

The Navy Department chose not to have the local utility buy this energy from the Potomac Electric Power Company and have the local utility build this transmission line; rather, the Navy Department insisted and the local utility, Maryland Light and Power Company, agreed to have the Potomac Electric Power Company construct this transmission line outside of their normal service territory to meet this defense need.

9318

The facilities provided are a 66,000 volt transmission line, being built at a cost of \$600,000, all of which is being provided by the Potomac Electric Power Company. The term of the contract is five years, but the rate is based on a twenty-year amortization of the investment on the part of the Potomac Electric Power Company, but no provision has been made in the contract for reimbursement to the Potomac Electric Power Company in the event of cancellation of the contract at any time after the five-year contract period.

This is one illustration of a specific answer to your ques-

—7,244—

tion,—where the presence of a strong operating property such as Potomac Electric Power Company has made possible the construction of these vital defense needs in an adjoining

territory where the local power company, by virtue of its capacity and size, is unable to meet the requirements imposed on it.

Q. Tell us of another case. A. There are two or three other illustrations in the territory of the Union Electric Company,—one of which is the power supply for Camp Fort Leonard Woods, near Rollo, Missouri.

This site, of 35,000 acres, was chosen for the Army Training Camp, the electrical demand for which was 7,000 kilowatts. This site is 100-miles southwest of St. Louis, and is served by two local utilities and an R. E. A.,—the Missouri General Utilities Company and the Missouri Electric Power Company, together with the LaCade Co-operative. However, the requirement of 7,000 kilowatts was quite in excess of any of these suppliers to meet, and only the Union Electric Company whose transmission line passed within 23 miles of the Camp had adequate facilities to meet with such requirements.

9320

The U. S. Army Engineers worked in conjunction with the engineers of the Union Electric Company and have arranged for the Union Electric Company to provide facilities on its electric transmission line, the construction of a sub-station there, and the building, by a contractor with funds, in this case, provided by the Government through the R. E. A., to deliver energy from the transmission line of

9321

—7,245—

the Union Electric Company to the Army Camp.

Now, much of the engineering was done by the Union Electric engineers and in this case, they are selling the energy at their transmission line, although serving a load 23 miles distant.

9322

Elmer L. Lindseth—By Respondents—Direct

Another case, again affecting the Union Electric Company of Missouri, relates to the Weldon Springs T. N. T. plant which also is outside of the service territory of the Union Electric Company. This, too, is a Government project and is on 20,000 acres of land northwest of St. Louis,—and is for a T. N. T. plant which it is hoped to have in service by September 1st, this year, a very fast construction schedule.

9323

An isolated power plant to be built on the site was quite out of the question, even with Government priorities, from a construction point of view.

The demand is for an immediate 5,000 kilowatts, up to 8,000 kilowatts, with a likelihood of a 12,000 kilowatt demand in the near future.

9324

The territory is served by a local utility, The East Missouri Power Company, which is wholly unable to supply a load of such character, and again, the Army representatives approached the engineers of Union Electric Company and those engineers have made the necessary calculations, engineering, designing, and are providing a sub-station, in this case, and about 6 miles of transmission line are to be built

—7,246—

by the Union Electric Company.

The local power company not only was unable to handle the major requirement of the ultimate project, but was even unable to handle the amount of energy required by the contractors during the construction and it has been necessary for these contractors to provide portable Diesel generating equipment to furnish even the necessary lighting for the night work.

Elmer L. Lindseth—By Respondents—Direct

9325

A third case, in this instance in or near the territory of the Mississippi River Power Company, is the Government shell loading plant at Burlington, Iowa, properly known as the Burlington Cartridge Loading Plant.

Here, the Government will erect a power plant of its own to furnish the steam necessary for the production of energy, but requires 3,000 kilowatts of emergency standby service. The local utility serving the area, the Iowa Southern Utilities, was unprepared to handle a load of this magnitude and the Mississippi River Power Company was approached and has agreed to furnish the necessary 3,000 kilowatts of standby service.

9326

These three or four instances illustrate the long range planning, thinking, and financing and construction program of The North American Company and the constant providing of facilities not only necessary to meet current needs, but with adequate flexibility and foresight and forward planning to meet extraordinary needs as have arisen from the Defense program.

—7,247—

9327

Mr. Browning: That is all I have.

The Examiner: We will recess until 2:00 o'clock.

(Whereupon, at 12:40 o'clock, p. m., the hearing in the above entitled matter was recessed until 2:00 o'clock, p. m., that same day.)

—7,248—

9328

Elmer L. Lindseth—By Respondents—Cross

AFTERNOON SESSION

The Examiner: All right, gentlemen.

Whereupon, ELMER L. LINDSETH, called as a witness on behalf of the Respondents, having previously been duly sworn, resumed the stand and testified as follows:

Cross Examination by Mr. Binford (Continued):

9329

Q. Mr. Lindseth, in connection with the correction which you indicated would be made to Sheet E of Exhibit 124 of the Respondents in order to show that the figures there set forth in respect of the Wisconsin Electric Power Company did not give due credit to that company in that the so-called "10 for 1" plan for that company was not reflected, did you make any investigation into any factors which might lead to a similar conclusion in regard to the non-North American companies which are included in the stated averages shown on the table; that is, did you investigate to see whether or not such other companies which in the comparisons made might be entitled to have some adjustment of the figures shown here because of promotional plans employed by such

9330

companies? A. The circumstances are these: These data are in all cases precisely as reported by the Federal Power Commission on representations of the companies reporting.

—7,249—

In the case of The North American system companies reported, they are in all cases the filed schedules as reported to the Federal Power Commission.

In no case that I know of, nor that has been brought to my attention, is there in use a plan similar to the Wisconsin "10 for 1" plan. The situation is just that.

Q. You do not know of any factors, whether similar to the so-called "10 for 1" plan or dissimilar, which might affect the figures involved in these several stated averages in any similar manner to that in which you sought to correct the figures given for the North American companies in Wisconsin? A. The particular work that was done on this table was done by a rate specialist in my office at The North American Company, who is one of extremely wide experience in rate matters, many years ago was a rate specialist with the Colorado Public Utilities Commission, has been for a number of years a member of the rate committee of the Edison Electric Institute, and now is, in his capacity as rate specialist at the North American Company, a person abreast of and intimately familiar with rate practices of virtually all companies in the country.

9332

He has supervised the taking off of these data from the Federal Power Commission reports, has made or supervised these calculations, and discussed this thing a great many

—7,250—

times with me when we were laying out and developing this study, and to his knowledge and his experience, which is much broader than mine, no such case has come to his attention.

9333

Q. So that the only correction for deviations from the filed rates which you have seen fit to make in this table is the deviation in respect of the North American subsidiaries indicated, namely, Wisconsin companies? A. And in the case of the Wisconsin Michigan system, only in the case of the Wisconsin Electric Power Company, which is the only one of those three companies which has the "10 for 1" plan in operation.

9334

Elmer L. Lindseth—By Respondents—Cross

Q. Now, with respect to Respondent's Exhibit 140, which purports to reflect the evolution of electric transmission in certain areas served by The North American Company subsidiaries, of course, except to the extent that you noted in your answers to the questions I have already asked you upon this exhibit, no transmission lines not owned by operating companies of The North American Company System are shown on the exhibit? A. Is your question directed to what lines in addition to those we discussed this morning might be shown?

9335

Q. Yes. I understand there are none. A. Other than the two lines we discussed this morning, to my knowledge there are none.

—7,251—

Q. Of course, as far as that portion of the exhibit designating the situation in 1910 is concerned, it is impossible to tell from an examination of the exhibit what transmission lines exist in the territory which were not owned by subsidiaries of the North American system? A. Well, that comment would prevail not only as of 1910 but throughout the entire period of evolution. Lines owned by companies other than those in the North American system are not, of course, shown.

9336

Q. And no distinction is made upon the exhibit purporting to show the evolution of these electric transmission lines as between transmission lines acquired by North American companies and transmission lines constructed by North American companies? A. No such attempt is made, no.

These lines will include the lines built by all predecessor companies of the present North American properties.

Q. So that possibly this exhibit might be more properly captioned as the evolution of ownership of electric transmission lines by The North American Company within certain areas, is not that true? A. No, I do not believe I could quite agree with that, because these drawings have been, in all cases, sent to the field to be checked by the engineering departments of these companies, and they do faithfully reflect those lines which were present in the areas now served

—7,252—

by the present company in the North American system.

9338

So that a blank spot in the middle of Missoari, in the 1910 map, may be taken as adequate evidence that there were no such lines there in 1910, whether of our ownership or the ownership of any predecessor company now making up either the Union Electric of Missouri or Missouri Power & Light.

Mr. Binford: I have no further questions to ask of Mr. Lindseth and do not expect to have any further questions; however, I would like to make the same reservation as heretofore in respect of further cross examination.

Mr. Browning: As usual, we object to the reservation.

9339

Redirect Examination by Mr. Browning:

Q. Mr. Lindseth, I am not sure that the record is entirely clear as to what this map purports to show. If I understand the situation correctly, the map shows the transmission lines which existed in those service areas at the time in question, even though they were owned by a predecessor company? A. That is a correct understanding.

9340

Elmer L. Lindseth—By Respondents—Redirect

Q. So that, in other words, the map which is captioned "1910" shows all of the lines which existed in those service areas at that time, and similarly in the case of each of the other maps? A. That is correct.

—7,253—

Q. And you want your testimony in response to Mr. Binford's questions to be so understood? A. Yes.

Mr. Browning: Off the record.

(Discussion off the record.)

9341

By Mr. Browning:

Q. Am I correct, Mr. Lindseth, in understanding that the map is intended to relate only to the present service areas of the subsidiaries, in other words, that you are not purporting to show either the presence or absence of lines outside of those service areas? For example, no lines are shown in the state of Minnesota; you are not purporting to show either the presence or absence of lines in Minnesota? A. That is correct.

9342

Q. What you are purporting to show is the development of transmission in the present service areas of the subsidiaries, and therefore you have shown all lines which existed in that area on the respective dates, whether owned by present companies or by predecessor companies? A. That is correct.

Mr. Binford: I would like to ask one or two questions that I failed to ask a moment ago.

The Examiner: All right.

—7,254—

Recross Examination by Mr. Binford:

Q. With reference, Mr. Lindseth, to Respondents' Exhibit 141, I note that the figures given there purport to be for cities of 50,000 population and more served by privately-owned electric utilities. You have no comparable figures in respect of cities of like population served by publicly-owned utilities, have you? A. The data are, of course, all available from the original source, the Federal Power Commission typical electric bills in cities of 50,000 population and more.

9344

Q. Why do you restrict your comparisons here to privately-owned electric utilities? Is the comparison more or less favorable than if you included the municipally-owned utilities, in respect of the North American subsidiary companies showing? A. Well, that cannot be determined,—and refer to a comparison of bills between a city served by a privately-owned utility and a city of similar size served by a publicly-owned utility,—because of the inadequacy of municipal or publicly-owned rates, as a basis of estimating the total cost to the consumer.

9345

For example, there is a very marked tax differential, well known, as between publicly-owned utilities, which pay ordinarily no taxes, and privately-owned utilities, which do, and

—7,255—

of necessity include in their bills and charges enough revenue to meet their tax bill.

Q. Well, conceding that there are such different factors involved as to raise doubt as to the propriety of the comparison, yet nevertheless is it not true there are numbered among the cities which have the lowest rates, of the classes

9346

Elmer L. Lindseth—By Respondents—Recross

shown on Exhibit 141, cities which are served by municipally-owned or governmentally-owned utilities, that is, conceding that you may have an argument as to whether or not that is a proper comparison or not, but leaving that argument aside for the moment? A. If we speak of the bill alone—

9347

Q. Yes. A. (Continuing)—and which, of course, anyone conversant with rates and charges in the industry knows is in the case of publicly-owned utilities only a part of the cost of service to the consumer. There are but 21 cities in this size group which have publicly-owned plants. Among those twenty-one are certainly some which do have a lower bill to the consumer for a given amount of electricity than some of the subsidiaries of registered holding companies, some of The North American Company system properties, or some of the companies not subsidiaries of registered holding companies, but the inadequacy of the comparison is obvious.

—7,256—

9348

The bill for electric service alone is only a part of the cost of service to a consumer when he takes service from a publicly-owned body.

Q. But if the bill alone were taken into consideration and municipally-owned and other governmentally-owned services were taken into account in the Exhibit 141, the rates would average lower than they do as now computed, is that not true? A. Well, I think it might then be necessary to add an additional column, because these columns, none of them are so captioned as to permit the inclusion of a publicly-owned utility under any of these headings.

Q. Do you know whether the electric utility system in Chattanooga is publicly or privately owned, Chattanooga,

Tennessee? A. Yes, Chattanooga, Tennessee is one of the cities in this group served exclusively by a publicly-owned utility.

Q. Are not the rates there the lowest or next to the lowest of any in a city of over 50,000 population in the United States? A. There are included in this table, as a basis for comparison, in the column "Subsidiaries of All Other Registered Holding Companies," a city which has lower rates than Chattanooga, Tennessee.

Q. What city is that? A. Cincinnati, Ohio.

9350

—7,257—

Q. Which is served by what system? A. Columbia Gas & Electric, Cincinnati Gas & Electric Company.

Q. Is there included within this tabulation any city of over 50,000 population served by the North American system which has lower rates than the city of Chattanooga? A. A. The city of Cleveland, Ohio, with which I am quite familiar, has rates, at 15 kilowatt hours per customer, which are 60 cents per month. No city in the United States, either publicly or privately, has a lower rate at 15 kilowatt hours per month than does Cleveland, either the rates of the Cleveland Electric Illuminating Company or the municipal plant at Cleveland, both of which are equal.

9351

Q. Is that true as to 25 kilowatt hours per month, and 100 kilowatt hours per month, and the classifications shown upon your Exhibit 141? A. That would not be true at any of those three uses.

Q. So that comparisons may be favorable or unfavorable to a large extent depending upon the units of kilowatt hours per month that you choose at the point at which to make the comparison, is that not true? A. The fallacy to which

9352

Elmer L. Lindseth—By Respondents—Recross

you refer is a fallacy which fails to consider the range of uses and an average of a substantial number of companies.

This exhibit purports to do only one thing; it purports

—7,258—

to compare the rates and charges for the average of twelve cities served by The North American Company with the rates and charges in 186 cities of 50,000 population and more served by privately-owned utilities.

9353

It indicates, for example, that throughout the range of use, from 25 kilowatt hours per month to 250 kilowatt hours per month, the average rates of the twelve cities served by The North American Company are very substantially lower than the rates served by cities of that size class, whether served by subsidiaries of other registered holding companies or companies not subsidiaries of registered holding companies.

9354

It is seen, for example, that companies not subsidiaries of registered holding companies charge 30 per cent. more for the same amount of energy than do North American Company properties. That is the purpose of the exhibit, and that is demonstrated herein.

To compare a publicly-owned utility, subsidized in substantial measure in its cost of service, is not a part of this exhibit, nor is it a valid comparison; but these companies are all private enterprises, doing business in industrial and other metropolitan communities of this size class, under substantially equal conditions, the American competitive system; they are within the ability to compare, and especially the more so when we consider averages of very substantial number, such as twelve North American Company cities, almost

—7,259—

one hundred cities subsidiary of registered holding companies, and thirty or forty cities served by companies not subsidiaries of registered holding company.

Q. But you are not prepared to state that the companies compared have uniform rate schedules, that is to say, that the point of decrease per kilowatt hour, let us say, in a block system, is the same in the case of each company in the table, or anything of that character, as I believe you have already illustrated by your statement relative to taking Cleveland at 15 kilowatt hours per month and making a comparison; that is to say, the change in rate per kilowatt hour occurs, does it not, at different points in the rate schedules of these different companies that are listed? Do I make my question clear? A. Well, it is a pretty long question by now. Perhaps we could have it read back.

9356

(Whereupon, the pending question was read back by the reporter.)

The Witness: With regard to the uniformity of rate schedules, and any feeling on my part that these companies might serve under schedules which have a break, so-called, at a uniform point, I can say unequivocally, of course, that these have a wide variety of such schedules and that they do not in any sense of the word have a uniform point at which the rates do
—7,260—
reduce.

9357

Q. Now, the cities of 50,000 population or over, the statistics concerning which enter into the figures shown on Exhibit 141, include all cities of 50,000 population or over

9358

Elmer L. Lindseth—By Respondents—Redirect

in the United States which are served by privately-owned electric utilities, or do they not? A. Yes, the 486 cities included as of 1941 are all the cities in the United States of population of 50,000 or above served by privately-owned utilities.

Q. And that means all not served by municipally or governmentally-owned electric utilities? A. That is right. There are thirteen additional cities not included in this table served exclusively by municipal or other publicly-owned utilities.

9359

Mr. Binford: Subject to the reservation heretofore made, I have no further questions of Mr. Lindseth.

Further Redirect Examination by Mr. Browning:

Q. Mr. Lindseth, are the categories of kilowatt hours shown here, that is, 25, 100 and 250, standard categories used by the Federal Power Commission for comparative purposes? A. Yes, they are.

Q. Is that the reason that you picked them? A. That is.

9360

Q. Counsel asked you about comparisons with publicly-

—7,261—

owned utilities. If your companies paid no taxes, were subsidized as to capital and did not need to maintain honest depreciation accounts, could your rates be lower?

Mr. Binford: Objected to, on the ground that no proper predicate has been laid for the hypothetical question propounded, and that no such facts have been shown to exist, particularly as to inadequate depreciation, that is, in respect of any particular

Colloquy

9361

publicly-owned electric utility system, or of publicly-owned electric utility systems in general.

The Examiner: Objection sustained.

Mr. Browning: Mr. Examiner, I submit that it is a well known fact that many public utilities take no depreciation, or inadequate depreciation. It is a matter of common knowledge.

The Examiner: Does not that really call for a conclusion of the witness?

Mr. Browning: Counsel is pressing or is attempting to press a comparison which is obviously unfair. 9362

If the North American companies paid no taxes, it would obviously make a tremendous difference.

Mr. Binford: It has not been shown in this record—

Mr. Browning: (Interposing) I want to show, by asking this witness.

Mr. Binford: (Continuing) —that the municipally-owned utilities do not pay the equivalent of some taxes in some form.

—7,262— 9363

Mr. Browning: I think counsel knows.

The Examiner: Let us go back and read the question as propounded.

Mr. Binford: I insist upon the objection.

The Examiner: I beg pardon?

Mr. Binford: I insist upon the objection.

The Examiner: I understand. I want to reconsider it and see what the question was as originally made.

9364

Elmer L. Lindseth—By Respondents—Redirect

Will you read the question, please?

(Whereupon, the pending question was read back by the reporter.)

The Examiner: Off the record.

(Discussion off the record.)

9365

The Examiner: In view of the discussion which has followed, I think that question, after hearing it reread, should be rephrased. I concede that part of it may be proper and relevant and part not.

I will let you rephrase it, Mr. Browning.

By Mr. Browning:

Q. Mr. Lindseth, do you know that many, if not all of the publicly-owned systems pay no taxes? A. Yes, I know that to be a fact.

Q. If the North American companies paid no taxes, could they reduce their rates materially? A. Yes, they could.

9366

I have here, as of 1940, the relationship between the
—7,263—
taxes paid by the electric utilities of several of our properties as related to the electric operating revenue of those properties.

In the case of the Union Electric Company of Missouri and subsidiaries, for example, as of 1940, the taxes charged to electric operations were equivalent to 18.7 per cent. of electric operating revenue.

In the case of Missouri Power & Light Company, the taxes charged to electric operations were 16.5 per cent. of electric operations.

In the case of Kansas Power & Light Company, the taxes charged to electric operations were 20.2 per cent. of electric operating revenues.

Another group here, in the Wisconsin Michigan system, the electric, so-called electric taxes, that is, those taxes charged to electric operations, were \$6,400,000, which were equivalent to 22.4 per cent. of electric operating revenues.

9368

Were these properties exempt from those taxes and were the rates and charges throughout reduced on an ad valorem basis, that is, assuming that the electric taxes were spread equally over all classes of business, the system could show the same net operating income, the same net for common, that now prevails, with a reduction of 22.4 per cent. in rates.

I can say unequivocally that were these privately-owned utilities in Exhibit 141 exempt from taxes, due to that alone

—7,264—

their rates would be below the average for electric utilities in the country.

9369

Were they further to benefit from grants from the Federal Government in the amount of 45 per cent. of the cost of additions built subsequent to the date when the Federal Government began subsidizing such plants and were such capital available free of charge, without taxes, without interest, then the comparison would be even far more favorable to electric utilities because of the inherently more economical operation and greater efficiency.

Mr. Browning: That is all.

9370

Elmer L. Lindseth—By Respondents—Recross
David Friday—By Respondents—Direct

Further Recross Examination by Mr. Binford:

9371

Q. The conclusion, from what you last said, which you make is, is it not, inevitably that by reason of their freedom from taxation, municipally-owned plants should, if efficiently operated, be able to supply electric current to consumers at substantially lower rates than privately-owned plants? A. With free capital in the amount of 45 per cent. of the cost of plants and with freedom from taxes, which might average 20 per cent. of electric operating revenues, and under your further hypothetical premise, which is rather difficult to concede could happen, namely, that they should be under a basis of equal efficiency or economy, then obviously for the same net income that property which has exemption from taxation and free capital must have lower revenues.

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nues.

Q. I take it you believe in private ownership of electric utility systems? A. That is a valid conclusion.

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Mr. Binford: No further questions.

Mr. Browning: That is all.

(Witness excused.)

Mr. Browning: Dr. Friday.

Whereupon, DAVID FRIDAY, called as a witness on behalf of the Respondents, having first been duly sworn, took the stand, was examined and testified as follows:

Direct Examination by Mr. Browning:

Q. Will you give the reporter your name and address, please? A. My name is David Friday, and my address is 4525 Garfield Street, Washington, D. C.

Q. What is your present occupation, Doctor? A. My present occupation is that of a consulting and advisory economist and official in some research organizations.

Q. How long have you been a research and consulting economist? A. Merely that?

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Q. Merely that. A. Well, since 1925.

Q. What positions do you hold at the present time in the general field of economics and social sciences? A. I am at the present time director and chairman of the board of the National Bureau of Economic Research, and I am on the general economics committee of the Social Science Research Council; the principal one, as chairman of the board of the National Bureau of Economic Research.

9374

Q. How long have you been a director of that organization? A. Since its inception, that is, some 21 years now.

Q. And were you president of it? A. Yes, I was president of it for two years, from 1938 to 1940.

Q. Can you tell us any economic organizations of which you are a member? A. Well, I am a member of the American Economic organization and Econometrics Society, that is, of Great Britain, and American Statistical Association.

9375

Q. Are you a member of the American Academy of Social and Political Sciences? A. I am a member of the American Academy of Social and Political Sciences, yes, sir.

—7,267—

Q. Will you summarize, briefly, your experience in the field of economics and the social sciences? A. Well, I was educated at the University of Michigan and graduated there in 1908, and was made an instructor there in economics, in

9376

David Friday—By Respondents—Direct

that year, and taught economics; and from 1908 to 1911, I also taught a course in public finance there, in two of those years.

In 1911, I undertook the courses in accounting and retained one of the advance courses in economics and a course in public finance.

9377

In 1912, I became an associate professor there in economics and finance, and in 1913, a full professor, and in 1914, became secretary of the courses in commerce. That was the administrative position at the head of the commerce courses there.

I left the University of Michigan in 1916, and went to New York University, where I was in charge of the graduate courses in value and valuation and also the course in public finance; and in 1917 I became head of the department of economics at New York University.

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I left the University work in 1918, in the spring of 1918, April, 1918, to come to the United States Treasury, as economic and statistical advisor there, and plan the war taxes.

From there I went, in September 1918, to the Telegraph

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and Telephone Administration, which was in the Post Office Department, under Postmaster General Burleson, and was advisor in the matter of awarding compensation,—determining compensation for the telegraph and telephone companies during the period of government control, which lasted from January, 1918 to July, 1919:

In September, 1919, I returned to the University of Michigan, as professor of economics and finance, and had

charge of the courses in credit, price levels and business cycles. I remained there until the summer of 1921, when I became president of Michigan Agricultural College, and I was president there for two years, until 1923.

At the end of that time I came to Washington, D. C., and became director of research in the National Transportation Institute, and also lectured at Brookings Graduate School in public finance, and I was there until 1925, when I went to Europe.

Q. Have you acted as advisor to any governmental or state commissions or authorities? A. Yes.

I was economist in 1911 to the Commission of Inquiry into Taxation. That was a special legislative commission of inquiry appointed.

In 1912 I was advisor to the Attorney General of the state in a 2-cent passenger rate case which he was trying.

—7,269—

In 1914, I was employed by the State Railroad and Public Utility Commission in connection with some matters in electric utilities, particularly Consumers Power Company. I wrote a corporate history of the Consumers Power Company for the commission there and determined its going value, and later in the year 1914 I was employed by the same commission in the matter of the reorganization of the Pere Marquette Railroad and rewrote the property accounts and income accounts and made a valuation of all their land and right-of-ways in charge of that valuation.

In 1918, as I said, I was with the United States Treasury planning war taxes, and then I went with the Postmaster General.

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9382

David Friday—By Respondents—Direct

In recent years I have been purely in advisory work and have been employed by the United States Government in various valuation cases involving taxes, particularly.

9383

Q. Did you act as economist for various industries in connection with the N. R. A.? A. Yes. During the N. R. A., the formulation of the codes, I was employed by the retail industries, that is, the National Retail Dry Goods Association and the hardware group, shoe retailers, hardware retailers, and was the economic advisor in connection with the formulation of that general retail code.

I was also employed by the Retail Tobacco Dealers Association, and was their economist in the matter of the formu-

—7,270—

lation of the code and the marketing agreement.

I might say that in 1921, when we had the Congressional inquiry into agriculture, I was employed as an economist to that committee in its work.

—7,271—

9384

Q. Doctor, from 1910 to date have you appeared as a witness on various economic matters before various courts and commissions? A. Yes, I have.

Q. Will you mention briefly some of your writings in the field of economics and social science? A. Well, I was teaching at the University of Michigan and I published a book on Reading in Economics. In 1920 I published a book on Profits, Wages & Prices. I also published and prepared Problems in Accounting. I was teaching in that field.

Q. Have you written articles on economic subjects for various magazines? A. Yes.

David Friday—By Respondents—Direct

9385

Q. What professional journals? A. Professional journals, The Journal of Political Economy which is a Chicago University publication; the Quarterly Journal of Economics which is a Harvard publication; The American Economic Review which is an organ of the American Economic Association and The Annals of Social and Political Science. I was assistant Editor on the last named publication from 1921 to 1927, The Annals of Social and Political Science.

Q. Have you also written articles in general magazines on economic subjects? A. Yes.

9386

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Q. Can you give us some names? A. The Atlantic Monthly, Manchester Guardian Commercial which is published in Manchester, Review of Reviews, World's Work, the Saturday Evening Post. I wrote quite a number of articles for the New Republic, in fact, I was a contributing Editor on that magazine from 1922 to 1926.

Q. Doctor, will you please mark this printed document titled "Area of Region" as Respondent's Exhibit No. 142.

The Examiner No. 142

9387

By Mr. Browning:

Q. Did you prepare this report, Respondents' Exhibit 142 for identification? A. I did, yes, sir.

Q. Did you have the assistance of Dillon Glendinning?

A. Yes, sir.

Q. Will you tell us who Mr. Glendinning is? A. He is a special research assistant in economics in the graduate school of Princeton, and held that position during the past year.

9388

David Friday—By Respondents—Direct

Recently he has been appointed fellow in social sciences for the coming year.

Q. Does this report accurately represent your views on the subject matter contained therein, Doctor? A. Yes, sir.

Mr. Browning: Mr. Examiner, just before offering this report as an Exhibit, I should like to state that our purpose in offering it in this form was to meet the Commission's request for saving time. It made

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9389

no difference to me whether we examined the witness on the subject matter as to his views on the matter, or submitted a written report, but we have taken the second alternative in view of the Commission's express desire to save time.

In offering it in evidence I am, of course, in effect offering it as a written statement of the evidence which Dr. Friday would give if questioned to each statement contained in the report.

With that understanding as to the purpose I offer this report as Respondents' Exhibit No. 142.

9390

Mr. Bindford; I object on the grounds, first, it would appear that the exhibit consists of conclusions and opinions of the writer thereof as to matters which must in of themselves be ultimate conclusions in this proceeding to be made by the Commission rather than to be submitted as purportedly evidentiary matter; secondly, numerous statements of fact, that is to say, of broad ultimate fact, for example, the statement of the number of passenger cars, the number of trucks owned on farms, appearing on page 19 of the Exhibit,

that is merely an example, are set forth in this booklet, while no proper predicate has been made for the making of such statements by this witness.

This is an unsworn publication. If it is to be permitted to be submitted and received in evidence in this case, it would appear that the only manner in which it could be properly received would be as a

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brief or argument rather than as an exhibit in evidence.

9392

Now, as the Examiner will have noted, this booklet is fairly lengthy. There are ten exhibits there too. This is the first time that counsel for the Division have been favored with a copy of it and I therefore wish to reserve the right after examination of the booklet to further particularize the ground of the objection thereto if necessary, but it seems to me apparent that if this work is to be used in this proceeding, its proper reception is not by way of evidence; not conceding, however, that it could be received as a brief, but if it is receivable as anything it seems to me that is the character in which it should be received.

9393

Mr. Browning: Taking up counsel's objections as I understand them, the first was that the report contained ultimate conclusions. What this report is, of course, is the report of an expert economist.

Mr. Binford: I object to the use of the term "Report". There has been no sworn statement in this testimony that this is a report of anything. On its

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Colloquy

face it purports to be an interpretation of the phrase—area or region, presumably as used in the Public Utility Holding Company Act of 1935, in fact, the first paragraph of the pamphlet so indicates.

The Examiner: Let counsel finish his argument, Mr. Binford; then you can make one.

Mr. Browning: A report on the economic significance of the region and the reason that we are sub-

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mitting it is that one of the tasks of the Commission, and ultimately the courts, will be the construction of this statute. Now one of the phrases in the statute is the phrase "Area or Region". We are submitting this evidence as to the economic view of a region so that its relevancy is obvious.

9396

Counsel objects that there are numerous statements of facts. I submit that the statements of fact contained in the report are only those which Dr. Friday could testify as an economist, and as I stated, my endeavor had been to accept the invitation of the Commission. The Chairman at the last hearing asked if we could submit something in report form and we do it and the practice is immediately attacked.

A further objection was made that the statement was unsworn. We have asked the witness to state under oath as to whether the report states his views. That was reaching the same result as if we had testified as to all the matters contained in the report.

As to counsel's final remark that he might, or might not have further objections after a thorough

examination of the report, it might well be advisable to take a short recess while both counsel and the Examiner examine it because it is really quite brief, and finally may I say that counsel's whole argument goes again to the weight of the evidence.

The Examiner: New Mr. Binford, do you want to renew your comments about whether this is a report, and have you anything further to say?

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Mr. Binford: Yes. This appears to be, as far as a brief survey of it will show, an attempt to urge certain interpretations of the phrase "Area of Region" as used in Section 2 (a) (29) of the Public Utility Holding Company Act of 1935. In fact, in the introduction of the report, the second sentence is as follows: "We are concerned here only with the meaning of the phrase 'Area or Region' as used in the above mentioned provision of the Act," referring to Section 2 (a) (29). 9398

If that isn't a subject for a legal argument, I don't know what it is, and as far as Chairman calling for any invitation or issuing any invitation for submission of reports, I am not in agreement with counsel for the Respondents if his impression of that request was that reports be submitted by that name which in effect were briefs. The question in issue is one of law as distinguished from a summary of facts which might be proper for the Examiner to receive in evidence. We might as well receive in evidence mere books, law review articles, treatises by economists other than 9399

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Colloquy

Dr. Friday, and specimens of political science as well as legal arguments not written by economists as to receive this. It is wholly argumentative and based upon the opinion of these two gentlemen who appear to be the authors as to the meaning of the words of the statute. There is no place in evidence for it whatsoever.

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Mr. Browning: Could I clarify the issue. Of course counsel and I are going to argue later before the Commission as to the proper construction of the sec-

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tion of the statute. There is no question about that. The purpose of this report is to put into the record the economic meaning of the word. We will argue later as to the entire question of statutory interpretation. We certainly are entitled to put in economic evidence on that subject.

9402

Mr. Binford: May I ask if counsel also intends to furnish lexicographer to introduce further evidence as to the meaning of words.

The Examiner: Well, gentlemen, on objections of this sort the rule contemplates that they should be in short form, and I have let you gentlemen make these statements in order that your position is made clear in the record. Now we will go off the record for a while. Before doing so, I want to say that I will accept counsel's invitation to examine this for a few minutes and it might be well for the counsel for the Division to do so likewise, so we will go off the record while we look at this, while we review this article.

(Whereupon a short recess was taken.)

David Friday—By Respondents—Direct

9403

The Examiner: I will reserve a ruling as to the admissibility of Respondents' Exhibit 142 for identification.

Mr. Browning: Just to have the record clear, Mr. Examiner, for your ruling on the matter, I understand that counsel's objections are not directed to the form, that is, the fact that a written report is offered in lieu of detailed testimony with questions and answers, but it is rather to the contents of the docu-

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ment itself.

Mr. Binford: That is correct.

By Mr. Browning:

Q. Doctor, you have stated that the report accurately reflects your views on the matters set forth therein? A. Yes.

Q. May I ask you specifically whether the map 10 annexed to the report specifies your views as to the correct limits of the middle west region.

Mr. Binford: I object upon the grounds that it is not shown that the correct bounds of any middle west region has been stated or implied in the question at issue in this case, therefore, the question calls for material that is irrelevant and immaterial. 9405

The Examiner: I will let him answer. I overrule the objection.

Mr. Binford: Note my exception.

The Witness: It does, yes.

Mr. Browning: That is all.

9406

Colloquy

Mr. Binford: I have no questions to ask of the Doctor at this time pending the ruling of the trial examiner upon the offer of Respondents' exhibit for identification, No. 142, and I reserve the right for cross examination.

The Examiner: Very well, the witness may be excused.

(Witness excused.)

9407

The Examiner: Before adjoining, I would like to get from Mr. Binford something further on the ques-

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tion of the admissibility of the four sheets, Respondents' Exhibit No. 124, and the testimony of Mr. Freeman on related matters, as to which I have reserved a ruling.

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Mr. Binford: Mr. Examiner, the last that was said by way of argument in that connection was Mr. Browning's remark to the effect that the argument made by me was one which should be fundamentally addressed to the weight to be given to the exhibit rather than its relevancy. I can't concede that position. What this exhibit does is to bring into this present case the size of industries for comparison with the size of North American Company and I presume of certain of its divisions, that is to say, the North American System rather than the corporate organization, which are proof of nothing but the fact that there are other organizations in the world as large, or larger than the North American Company.

That doesn't without an examination into the efficiency of the operation of these companies, their manner of operation, tend in any way to prove that size increases efficiency, or decreases efficiency, or has any other bearing upon the operation of the company.

If this material is relevant, then it would be only appropriate and just that the inquiry be extended further into the intricacies and detail of the operations of these companies.

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The Examiner: I agree the point is whether or not these sheets and the testimony to which you objected is relevant; whether it will open up additional fields,

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other fields, strikes me as being besides the point. The question is whether this is relevant or not, and not to whether it is going to open up other lines of investigation, other fields.

Mr. Binford: I was pointing out the latter point as showing not only was it irrelevant in the ordinary acceptance of the term, but it was irrelevant in that it had little meaning standing alone, that is, these data have little meaning standing alone, and could be relevant only in any acceptance to the term by the inclusion of such additional matter that it is beyond the bounds of possibility that such additional matter could be brought into a proceeding of this kind. I suppose that some fact can have some relevancy to any other fact in the world, but from a legal sense, one isn't relevant to the other.

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Colloquy

The Examiner: I don't know that it would necessarily open up any new fields. I was just thinking out loud for the moment. Have you anything further to add Mr. Browning?

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Mr. Browning: Yes. I must say that the argument that the evidence which is offered goes into a new field as an objection to the relevancy is an argument that I have never heard before. I simply don't see what it has to do with its relevancy. The question is—does the evidence offered bear on the issues in the case. One of the major issues in this case could be paraphrased as—how big is too big? Our position is that you can't decide that question in a vacuum and any one before deciding it, deciding the question, should

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9414

start with an open mind and shouldn't just arrive at the decision by bringing down some answers from the blue sky. For example, as regards area, people have preconceived notions what is big. One of the reports recently prepared by the staff was very much concerned about the size of the U. G. I. area, which I believe was some three hundred odd miles square. The Kansas Power & Light Company, as the testimony in this case has shown, has one operating division that has three thousand square miles in it and they don't think anything of it in Kansas. Now, I don't think that we can decide these things in a vacuum. We have got to have some information, some bases of comparison. I submit that these figures which we have submitted are obviously relevant; they make you think about size. For instance, one of the tests of

size which might be employed is number of employees. I don't think that the Examiner any more than I did realized the number of employees a great many of these leading businesses have. I can conceive of a person who had not gone into the matter believing that \$5,000,000 would be a big utility; it represents only a generating unit today.

I really think that counsel's objection is directed to the weight which is a matter of argument later.

Mr. Binford: May I give you an illustration of what I mean? 9416

The Examiner: Yes, Mr. Binford.

Mr. Binford: Suppose that a doctor diagnosing a case tells a lady that she is over weight and should reduce. It certainly seems to me that it doesn't aid

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in his diagnosis or his treatment for the lady to point out that Mrs. Jones in the next town was just as fat, or more than the patient.

The Examiner: If that is an apt illustration, it doesn't weigh much then, does it? 9417

Mr. Binford: It doesn't weigh much but it is so irrelevant it shouldn't be in.

Mr. Browning: May I develop that. The Doctor's opinion on the lady's weight is based upon his knowledge of the weight of both men and women in thousands of cases with complete statistical information in front of him as a result of which he reaches his opinion. If counsel's hypothetical patient told the doctor that there were a number of people her weight who were more healthy since they had gained that

9418

Colloquy

weight, or who were perfectly healthy and gained that weight, that these people lived all around her, he would be a pretty poor doctor if he didn't consider it, so I could take his own analogy.

9419

I don't want to be met with the contention when we argue this size matter that we had the opportunity to put in evidence as to the size in other industries and didn't do it and that is just exactly the contention, not that this counsel would make, but that his successors would make.

The Examiner: I thank you gentlemen for the arguments that you have made and they will help me in deciding the matter.

I understand that counsel in an off the record discussion have agreed that this matter shall go over to next Tuesday at 10:00 o'clock, a.m. at which time I

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will dispose of the matters that I have under consideration.

9420

(Whereupon, at 4:30 o'clock, the meeting was adjourned to reconvene on Tuesday, April 15, 1941.)

—7,284—

Securities and Exchange Commission

DOCKET NO. 59-10

IN THE MATTER

of

THE NORTH AMERICAN COMPANY, *et al.*

9422

Hearing Room 622,
Securities and Exchange Commis-
sion Building,
18th & Pennsylvania Ave., N.W.,
Washington, D. C.,
Tuesday, April 16, 1941.

Met, pursuant to adjournment, at 10:00 o'clock a. m.

Before: WILLIAM W. SWIFT, *Trial Examiner.*

9423

Appearances:

S. PEARCE BROWNING, JR., and

(CHARLES S. HAMILTON, JR., of Sullivan & Cromwell, 48
Wall Street, New York, New York, appearing for the
Respondents.

RALPH C. BINFORD, appearing for the Securities and Ex-
change Commission.

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Colloquy

PROCEEDINGS

The Examiner: The hearing will come to order.

Mr. Browning: I should like the record to show at this time, Mr. Examiner, that we are furnishing to the staff corrections from page 1032 to page 6218, inclusive, of the record. I believe that these corrections cover all the testimony up to the end of March, although I am not certain as to the exact day when they end.

9425

In any case, we will expect to furnish the staff as promptly as possible with the corrections for the remaining portion of the record.

Meanwhile, it is our suggestion that the staff go over these corrections, with a view to advising us as to their approval or disapproval thereof or any additional corrections which the staff desires made, and we would then suggest that the corrections be made in the record.

Mr. Binford: That procedure is acceptable to us.

9426

The Examiner: All right, I think it is very desirable that these corrections be attended to.

I will wait until the Commission's staff check over this list, and perhaps there will be some additional corrections, at which time we will enter the corrections on the record as part of the record.

Mr. Browning: Off the record.

(Discussion off the record.)

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Mr. Browning: Could we have it understood, Mr. Examiner, that even though the record is closed before

Colloquy

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the staff has had an opportunity to complete its work on the corrections or before we have had a chance to submit the final list, that the corrections can be supplied later and that the record will be reopened for that purpose?

Mr. Binford: That is perfectly agreeable, and we so stipulate.

The Examiner: All right.

Off the record.

(Discussion off the record.)

9428

Mr. Binford: Let the record show that counsel for the Commission are making no request that any further minutes of the two intercompany committees which have been mentioned in this proceeding are requested to be put in evidence, and counsel for the Commission is undertaking to return the series of minutes which were delivered to the staff for inspection.

Mr. Browning: Off the record.

(Discussion off the record.)

9429

The Examiner: With reference to the question of the admissibility of Sheets C, D, F and I, which form a part of Respondents' Exhibit 124, and the motion to strike which Commission's counsel has lodged against a small portion of the Witness Herbert C. Freeman's testimony (Transcript Pages 7,012 to

—7,287—

7,014), I have reached the conclusion that such evidence is relevant and that the objections are really

Colloquy

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directed to the weight thereof, rather than to its relevancy.

The motion to strike is denied, and Sheets C, D, F and I are now admitted in evidence, along with the other sheets contained in Respondents' Exhibit 124 which have heretofore been received.

Mr. Binford: I respectfully except to each of the rulings of the Examiner contained in the statement last made.

9431

Mr. Browning: Off the record.

(Discussion off the record.)

The Examiner: Now Mr. Binford, turning to the other matter which I have under advisement, have you considered further the contents of the exhibit which was marked for identification as Respondents' Exhibit 142, and have you anything further to say about it?

I recall in some of your remarks you indicated you might like to particularize your objections.

9432

Mr. Binford: In view of the nature of the argument, it is difficult to particularize my objection any further than I have.

The Examiner: All right.

Mr. Binford: I still urge the objection.

The Examiner: Were this a legal proceeding rather than an administrative proceeding, the article in question would be clearly inadmissible. Since this

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is an administrative proceeding, where commonly established rules of evidence are relaxed, and since

Dr. Friday and the co-author of the article, Mr. Glendinning, are available for cross-examination by Commission's counsel, if cross-examination is desired, I have reached the conclusion that the article is relevant in some aspects at least, although it is in places somewhat argumentative.

The said article is admitted in evidence as Respondents' Exhibit 142, subject however to the right of cross-examination not only of Dr. Friday but of the co-author, Mr. Glendinning.

9434

Furthermore, if anything develops on such cross-examination of these witnesses as may be had, the counsel for the Commission may move to strike if he considers that the situation justifies such a move.

Mr. Binford: I respectfully except to the ruling of the Examiner in admitting the exhibit in evidence.

In view of the fact that this document has been admitted in evidence, there are a few questions which I would like to ask Dr. Friday, if he were recalled.

Counsel will remember that I stated that I did not know whether I would have cross-examination until the Trial Examiner ruled as to whether the document was admissible or not.

9435

Mr. Browning: Off the record.

—7,289—

(Discussion off the record.)

Mr. Binford: Now as to Mr. Glendinning, possibly it will not be necessary to cross-examine him, but I would like to have him available for cross-

9436

David Friday—By Respondents—Cross

examination, so that if the cross-examination of Dr. Friday indicates that some questions are advisable to Mr. Glendinning, he can be examined at that time.

Off the record.

(Discussion off the record.)

9437

Mr. Browning: From time to time, Mr. Examiner, Commission's counsel has reserved the right to recall each witness produced by the Respondents and we have objected to such reservation and you have reserved the ruling.

I understand that those motions will be considered withdrawn when the record is closed?

Mr. Binford: That is correct.

The Examiner: All right.

Mr. Browning: Off the record.

(Discussion off the record.)

9438

Mr. Binford: Mr. Examiner, it is now about eleven o'clock, and I should like to request a recess of about an hour before we proceed further with this hearing.

The Examiner: All right, we will recess until twelve o'clock.

(Whereupon, a recess was taken, as above.)

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(After recess)

(12:10 p. m.)

The Examiner: We will resume.

Whereupon, DAVID FRIDAY, (Resumed) a witness produced by the Respondents, having previously been sworn, resumed the stand and testified further as follows:

Cross Examination by Mr. Binford:

Q. Dr. Friday, I believe you testified you and Mr. Glendinning are the authors of this Exhibit 142, entitled "Area or Region", which was put in evidence? A. Yes, sir.

Q. Mr. Glendinning is a "fellow" did you say, of Princeton? A. He was graduate student there, and is a fellow for this coming year; graduate student in the Graduate School and also assistant to Professor Frank Graham there.

Q. You testified before the Committee on Interstate and Foreign Commerce of the House of Representatives in opposition to the Public Utility Holding Company Act of 1935, did you not? A. Yes, sir.

9440

Q. And whom were you representing at that time? A. I was representing the Holding Company Executives. The

—7,291—

Association of Holding Company Executives, I believe, was the exact name.

Q. You were, of course, a compensated expert on their behalf? A. Yes, sir.

Q. That is true at the present time, is it? A. That is true at the present time.

9441

Mr. Browning: Off the record.

(Discussion off the record.)

The Witness: My statement in the affirmative was only directed to the question as to whether I was being compensated now as an expert.

I did not imply that I was being compensated by the Holding Company Executives, or whether I was working for them. I am not either one of those things.

9442

*David Friday—By Respondents—Cross**By Mr. Binford:*

Q. That is, not by the same Association of Holding Company Executives, but rather by The North American Company? A. By The North American Company, yes sir.

Q. Were you ever regularly retained as an economic advisor, or in any other capacity other than you have already mentioned, by the Committee of Public Utility Executives?

A. No, sir.

9443

Q. Have you been retained at any time as an economic advisor to any public utility holding companies, or in any

—7,292—

other capacity? A. By holding companies?

Q. Yes, public utility holding companies. A. I have been retained by some operating companies. I do not remember any—

Q. (Interposing) What were the operating companies?

A. Well, I was retained by the Georgia Power Company, the rate case there; I was retained by the New Jersey Public Service Company, in a rate case that they had; I was retained 9444 ° by Louisville Gas & Electric in 1933, in a rate case; and I was retained during the last year, that is, in March of last year, by Puget Sound Power & Light, in a condemnation case, involving the determination of the value of some property in Whatcom county, Washington, which property was being condemned by the Public Utility District of that county.

Q. Did you take the position in your testimony, in part, in opposition to the bill which eventually became the Public

Utility Holding Company Act of 1935, that the operations of public utility companies within the meaning of that measure, as distinguished from those of railways, for example, were so essentially local in character as to make them amenable to sufficient state regulation as far as the public was concerned? A. I do not remember what position I took on that particular question, whether I took any. I would have to

—7,293—

read the brief again, the brief I filed with the committee, which you have. I do not remember that.

9446

Q. You also testified orally in addition to filing the brief?

A. Yes, sir.

Q. You would not say that you did not take that position, would you? You just do not recall. A. No, I would not say that.

Q. You speak in the treatise which was introduced in evidence as Exhibit 142, of a science of regionalism. When did you say that science had been developed and recognized as such? A. Yes, sir.

Mr. Binford: Please read the question.

9447

(The pending question was read back by the reporter.)

The Witness: Well, I do not remember what I said. I did make a remark to the effect that for over 50 years it had been in the making, but not in the economic sense so much as it is now. It is particularly over the last 20 years, and certainly very intensively over the last decade, that this has had activity.

9448

David Friday—By Respondents—Redirect

I, myself, of course, was interested in it 20 years ago, when I was at the Michigan Agricultural College, as president.

By Mr. Binford:

Q. Your occupation at the present time is that of con-

—7,294—

sulting economist? A. That is correct.

9449

Q. Your clients are industrial companies, primarily—mostly? A. No, they are not.

Shall I tell you who they are?

Q. If you wish. A. I have been engaged over the last four or five years primarily for individuals and the United States Government in matters involving the valuation of properties, particularly the stocks, for purposes largely of gift taxes, administering the gift tax law and the State tax law, and that does not involve employment by corporations, industrial or otherwise. It is either by the Government or by the person or persons that are obligated for the tax.

9450

Q. Is this Exhibit 142 your first monograph on regionalism? A. That is my first formal monograph on regionalism, yes, sir.

Mr. Binford: I have no further questions.

Redirect Examination by Mr. Browning:

Q. You were asked whether you have been compensated for your work here or would be compensated, and you replied in the affirmative. Does the fact that you are compensated or

—7,295—

will be compensated affect the views which you have expressed? A. No, sir.

Mr. Browning: That is all.

Mr. Binford: No further questions.

(Witness excused.)

The Examiner: Off the record.

(Discussion off the record.)

Mr. Binford: Mr. Examiner, I suggest at this point that we recess until two o'clock.

9452

The Examiner: Very well, we will now recess until two o'clock.

(Whereupon, at 12.30 o'clock, p. m., the hearing was recessed to reconvene at 2:00 o'clock, p. m. of the same day.)

—7,296—

9454

Colloquy

(2:00 p. m.)

AFTERNOON SESSION.

The Examiner: Let us proceed.

9455

Mr. Binford: Mr. Examiner, as the Rules of Practice of the Commission do not provide for an Examiner's report in proceedings of this character, it would appear that the next step in this proceeding, after the closing of this hearing, will be the submission to the Commission of requested findings of fact by counsel for the Commission and by counsel for Respondents.

9456

In order that counsel for Respondents may be fully apprised of the nature of the findings which will be requested by counsel for the Commission, I think that it is appropriate that I state at this time, without undue particularization and without argument, the ultimate facts which counsel for the Commission will contend have been established by the evidence adduced in this proceeding, and in accordance with which position our requested findings of fact will be framed.

We take the position that the evidence herein establishes the following facts:

The holding company system of The North American Company is not confined in its operations to those of a single integrated public utility system within the meaning of the Public Utility Holding Company Act of 1935, and to such other businesses as are reasonably incidental, or economically neces-

sary or appropriate to the operations of such integrated public utility system.

—7,297—

The electric utility system of Potomac Electric Power Company and Braddock Light & Power Company, Inc. together constitute a single integrated public utility system. Washington Railway and Electric Company, the registered holding company, which is the immediate parent of Potomac Electric Power Company and which controls Braddock Light & Power Company, Inc., controls no other utility properties within the meaning of the Act. It has not been shown that the businesses of Capital Transit Company and the latter's subsidiaries, nor of Great Falls Power Company, are reasonably incidental, or economically necessary or appropriate to the operations of the integrated public utility system represented by properties and operations of Potomac Electric Power Company and Braddock Light & Power Company, Inc. 9458

Cleveland Electric Illuminating Company's properties and operations constitute those of a single integrated public utility system. The businesses of The Power & Light Building Company and the Ceico Company, subsidiaries of Cleveland Electric Illuminating Company, are reasonably incidental, or economically necessary or appropriate to the operations of the integrated public utility system of Cleveland Electric Illuminating Company. 9459

Likewise, the steam heating business carried on by Cleveland Electric Illuminating Company, is, to its present extent and at the present time, reasonably

—7,298—

Colloquy

9460

incidental, or economically necessary or appropriate to the operations of the integrated public utility system of that company.

The electric utility operations of Wisconsin Electric Power Company, Wisconsin Gas & Electric Company and Wisconsin-Michigan Power Company constitute those of a single integrated public utility system in so far as such electric utility operations are concerned.

9461

The businesses of the two non-utility subsidiaries of Wisconsin Electric Power Company, namely, Wisconsin General Railway Company and Milwaukee Electric Railway & Transportation Company, and the subsidiary, Badger Auto Service Company, of the latter, have not been shown to be reasonably incidental or economically necessary or appropriate to the operations of the integrated electric public utility system of which Wisconsin Electric Power Company's operations constitute a part. The heating business done in connection with the operation of this system appears, to its present extent and at the present time, to be reasonably incidental, or economically necessary or appropriate to the operations of the system.

9462

Union Electric Company of Missouri is a registered holding company as well as a public utility company. The electric utility operations of Union Electric Company of Missouri and of its electric utility subsidiaries, namely, Union Electric Company of Illinois, Mississippi River Power Company, Iowa

Union Electric Company, Cupples Station Light, Heat and Power Company and St. Charles Electric Light and Power Company constitute those of a single integrated public utility system within the meaning of the Act.

Union Electric Company of Missouri has three active subsidiaries which are not utility companies within the meaning of the Act. These companies are Union Electric Land and Development Company, St. Louis & Belleville Electric Railway Company and St. Louis & Alton Railroad Company. The business conducted by Union Electric Land and Development Company is presently reasonably incidental, or economically necessary or appropriate to the operations of the integrated electric public utility system of the Union Electric Company of Missouri group. The businesses of St. Louis & Belleville Electric Railway Company and St. Louis & Alton Railroad Company are not reasonably incidental, or economically necessary or appropriate to the operations of such system. The heating business conducted by Union Electric Company of Missouri appears to be reasonably incidental, or economically necessary or appropriate to the operations of the Union Electric Company of Missouri group electric utility system. Union Colliery Company is a direct subsidiary of Union Electric Company of Illinois. The business conducted by Union Colliery Company does not appear to be reasonably incidental, or economically necessary or appropriate to the operations of the system.

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Colloquy

Union Electric Company of Missouri, as a registered holding company, must be required to limit its operations in accordance with what has been said.

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Within The North American System proper, that is excluding for the moment properties in the North American Light & Power Company system, the Washington Railway and Electric Company system, the Cleveland Electric Illuminating system, the Wisconsin-Michigan system or the Union Electric Company of Missouri system might be retained by The North American Company as its single integrated system, but if any one of these systems be so retained by The North American Company, the retention of none of the others would be permissible by The North American Company as an additional system under the provisions of Section 11(b) (1) of the Act, and this would be true not only because of paragraph B of that section but also because such retention would not meet the requirements of either paragraph A or paragraph C of the Section.

9468

The business conducted by the non-utility subsidiaries of The North American Company, namely 60 Broadway Building Corporation, North American Utilities Securities Corporation and West Kentucky Coal Company (the New Jersey corporation) and the latter's direct and indirect subsidiaries are not reasonably incidental, or economically necessary or appropriate to the operation of any single integrated system presently controlled by The North American Company and the retention thereof, consequently, is

Colloquy

9469

not permissible under the Act, regardless of what system is retained by The North American Company as its "principal" single integrated system.

Now as to North American Light & Power Company:

North American Light & Power Company is a registered holding company. The holding company system of North American Light & Power Company is not confined in its operations to those of a single integrated public utility system within the meaning of the Act and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of any such single integrated public utility system. 9470

The retention by The North American Company of its interest in North American Light & Power Company cannot be justified as the retention of a public utility system or systems additional to any single integrated public utility system which The North American Company might retain as its "principal" integrated public utility system, nor could that interest be retained as constituting one in a business reasonably incidental, or economically necessary or appropriate to the operations of any such "principal" system. 9471

North American Light & Power Company must be required to take such steps as shall be necessary to limit its operations to those of a single integrated public utility system and to such interests in other businesses and to such other additional systems as

9472

Colloquy

may, respectively, be permitted under the terms of the Act.

9473

North American Light & Power Company has four direct subsidiaries which are public utility companies within the meaning of the Act. These are The Kansas Power and Light Company, Missouri Power & Light Company, The Blue River Power Company and Nebraska Natural Gas Company. The physical properties of Nebraska Natural Gas Company have been sold, or at least such sale has been approved by this Commission and is in process of consummation, so that Nebraska Natural Gas Company will have ceased to be a public utility company within the meaning of the Act within the next few days, and it has been stated that the company will be thereupon dissolved, and therefore any consideration of that company's operations will be unnecessary.

9474

The Electric utility system of The Kansas Power & Light Company together with the facilities and operations of The Blue River Power Company constitute a single integrated public utility system within the meaning of the Act.

The heating business of The Kansas Power & Light Company, to its present extent and at the present time, would appear to be susceptible of retention by The Kansas Power and Light Company as an interest in another business permissible under Section (11)(b)(1), but the transportation, water service and manufactured ice business engaged in by that company are not reasonably incidental, or economic.

ally necessary or appropriate to the operations of its utility systems.

The electric utility system of Missouri Power & Light Company, with the exception of its properties and operations in Henry county, Missouri, constitute an integrated public utility system within the meaning of the Act. The facilities in Henry county are not interconnected with those of the remainder of the system, nor are the operations in that locality otherwise susceptible of inclusion within the integrated electric public utility system of the company.

9476

The heating business conducted by Missouri Power & Light Company, to its present extent and at the present time, appears to be retainable as a business reasonably incidental, or economically necessary or appropriate to the operations of the electric utility system of Missouri Power & Light Company. The water business and ice business conducted by the Company would appear to be not so retainable.

North American Light & Power Company has two direct subsidiaries which are holding companies within the meaning of the Act and are registered as such. These are Illinois Traction Company and Northern Natural Gas Company.

9477

Illinois Traction Company has four direct, active subsidiaries; namely, Cahokia Manufacturers Gas Company, Kewanee Public Service Company, Western Illinois Ice Company and Illinois-Iowa Power Company.

9478

Colloquy

The electric utility operations of Illinois-Iowa Power Company, conducted by it directly, as distinguished from those carried on by its subsidiaries operating in Iowa, with certain exceptions, constitute those of a single integrated public utility system.

9479

The electric utility operations of Kewanee Public Service Company can be regarded as a part of this single integrated public utility system, in so far as retention of control thereof by Illinois Traction Company is concerned.

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The electric facilities of Illinois-Iowa Power Company in and about Jacksonville, Enfield, El Dorado and Shawneetown, and Mound City and Cairo, are not interconnected with each other nor with any other portions of the Illinois-Iowa Power Company's electric utility system, nor have they been shown to be so susceptible of interconnection therewith as to render the consideration thereof as a part of the single integrated electric public utility system of Illinois-Iowa Power Company and Kewanee Public Service Company permissible under the Act.

Moreover, it does not appear that the retention thereof as systems additional to the large single integrated electric public utility system of Illinois-Iowa Power Company and Kewanee Public Service Company can be justified under paragraphs A or C of Section 11(b) (1) of the Act.

Western Illinois Ice Company does no business of a character which would justify the retention thereof

—7,305—

by Illinois Traction Company.

Illinois-Iowa Power Company, in addition to being a public utility company, is a registered holding company. Therefore, it, also, must limit its operations in conformity with the provisions of Section 11 (b) (1) of the Act.

In addition to the single integrated electric utility system heretofore delineated and to the other electric utility operations, Illinois-Iowa Power Company has a subsidiary which is both a public utility company and a registered holding company, namely, Des Moines Electric Light Company, the sole subsidiary public utility company of which is Iowa Power and Light Company. 9482

The electric utility operations of these two companies constitute those of a single integrated public utility system. The gas utility operations of these two companies, likewise, constitute those of a single integrated gas utility system.

Neither the gas utility system of the Iowa companies nor the electric utility system of such companies could be retained, under the standards of paragraphs A and C of the Act, by a holding company retaining the Illinois electric or gas utility systems of the Illinois-Iowa group; nor can such Iowa operations and Illinois operations be regarded as together constituting those of a single integrated public utility 9483

—7,306—

system.

Illinois Terminal Railroad Company and Central Terminal Company are non-utility subsidiaries of

9484

Colloquy

Illinois-Iowa Power Company. The businesses of these companies are not reasonably incidental, or economically necessary or appropriate to the operations of any single integrated public utility system which might be retained by Illinois-Iowa Power Company.

Northern Natural Gas Company is a subsidiary of North American Light & Power Company and is a registered holding company, its subsidiaries being Peoples Natural Gas Company and Argus Natural Gas Company, Inc., each a gas utility company.

9485

It is my understanding that an application has been filed on behalf of Northern Natural Gas Company for a reclassification of its stock and that a disposition thereof is expected to be made in the very near future.

Under these circumstances, it may be unnecessary to give further consideration to these companies at this time.

9486

Power & Light Securities Company is not susceptible of retention by North American Light & Power Company in connection with any integrated public utility system.

North American Light & Power Company must limit its operations to one of the single integrated public utility systems presently controlled by it. Except as has been previously pointed out in this statement, no two or more of such integrated public utility sys-

—7,307—

tems can be retained by North American Light & Power Company under the provisions of paragraphs A, B and C of Section 11(b) (1) of the Act.

Similarly, and with the exceptions heretofore stated, Illinois Traction Company must limit its operations to those of a single integrated system, as must Illinois-Iowa Power Company and Northern Natural Gas Company.

In view of the relative unimportance of the gas utility operations by the companies of The North American Company system, it would not appear probable that any one of such systems would be retained as the principal integrated utility system of any of the several holding companies in the system. 9488

Evidence has been adduced upon the part of the Respondents tending to show that these numerous gas utility systems might be retained under the standards of paragraphs A and C of the Act as systems additional to the electric utility systems in connection with which they are presently operated.

I am not prepared at this time to state to what extent this appears to have been proven. It may be that counsel for the Commission will merely request specific findings of fact in this respect, leaving the ultimate question for decision by the Commission without any requested findings in respect thereto. 9489

The Commission will be asked to enter an order directing The North American Company, North American Light & Power Company and each of the other

—7,308—

registered holding companies within The North American system to take such steps as may be necessary to limit their respective holdings and operations in accordance with the findings so requested.

9490

Colloquy

The status of Pacific Gas and Electric Company and that of The Detroit Edison Company are presently being litigated. It is the claim, in each case, of The North American Company that these two companies are not subsidiaries of The North American Company.

9491

If these companies are finally determined to be subsidiaries of The North American Company, whether or not each constitutes a single integrated utility system within the meaning of the Act, neither could be retained by The North American Company as a system additional to any other system presently admitted to be controlled by it, because of the requirements of paragraphs A, B and C of Section 11(b) (1).

Furthermore, if the interest of The North American Company in these two utility companies is regarded as an investment, it is an investment, in each case, which cannot be retained by The North American Company under the provisions of Section 11(b) (1) of the Act.

9492

Mr. Browning: Off the record.

(Discussion off the record.)

Mr. Binford: Mr. Examiner, if counsel for the Respondent will place in evidence the following:

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1. Consolidating balance sheets covering the entire system, that is, the system of The North American Company and all subsidiary holding companies and operating companies therein for the past three calendar years, 1938, 1939 and 1940, together with

operating statements for the same period covering all companies, and surplus analyses for the same period in respect of the same companies, such financial information to be submitted in the same form as required for the so-called U-5S statements of the respective years covered;

2. For the calendar year 1940, the same information relative to compensation of officers, directors and employes, as required by the U-5S statement of the Commission in force at the present time;

9494

3. A copy of the charter and by-laws of The North American Company as amended to the present time;

4. Certain statistics on certain operating subsidiaries for the year 1940, in form to be agreed upon by counsel; and

7
5. Certain data heretofore agreed to be supplied by Witness Hight on the expenses of the Decatur general office; counsel for the Commission will then withdraw, if satisfactory to counsel for Respondents, the documentary evidence heretofore offered on the part of the Commission, in its entirety, with the exception of the exhibits relating to the matters of notice of hearing, designation of trial examiner, service of

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—7,310—

process, and other procedural rather than substantive matter.

Mr. Browning: Could I restate our understanding, simply to be clear?

I would prefer that the record show that counsel's exhibits, with the exception of the last mentioned

9496

Colloquy

procedural exhibits, are withdrawn upon the understanding which we now confirm, that the Respondents' counsel will furnish the additional matter which is tabulated above.

In other words, I would like the record to be clear that the Commission's exhibits are withdrawn upon that understanding.

9497

Mr. Binford: That is satisfactory to us, on the furnishing for the record of the information so suggested in my previous statement.

The Commission's exhibits, with the exception mentioned, will be deemed to be automatically withdrawn from this case.

Mr. Browning: As to the time of furnishing the information requested, I should like to leave it that we will do our very best under the circumstances.

As we have pointed out, certain of the information may not be quite ready as yet. We will furnish the information as promptly as possible.

9498

Mr. Binford: Well, of course, we expect them to be furnished in a reasonable length of time, at such time as can be referred to if necessary in any findings

—7,311—

and briefs that may be filed.

Mr. Browning: Off the record.

(Discussion off the record.)

The Examiner: When this data is supplied, it will be incorporated in this record by me, as soon as received, under appropriate exhibit numbers, starting

Colloquy

9499

with the next number, which is Respondents' Exhibit 143.

Counsel, of course, will inform me when he has completed filing the data specified in the stipulation above agreed upon.

Mr. Browning: Off the record.)

(Discussion off the record.)

Mr. Binford: Mr. Examiner, may I state for the record that the exhibits excepted in my statement, that is, those that are to be retained in the record as exhibits of the Commission, are those numbered from 1 to 9, inclusive. 9500

The others are those which are to be deemed to be withdrawn upon the furnishing of the several exhibits by counsel for the Respondents.

The Examiner: I think it is well to have that clearly in the record, Mr. Binford.

Mr. Browning: Could I state my understanding for the record, that it is not necessary to offer Respondents' answer in evidence, or any of the other pleadings? 9501

—7,312—

The Examiner: Yes, I think that is in order.

Mr. Binford: And not only pleadings, but also orders.

Mr. Browning: Yes.

Mr. Binford: I agree.

Mr. Browning: Yes.

9502

Colloquy

Mr. Binford: Counsel for the Commission has nothing further to offer. We rest.

Mr. Browning: Counsel for the Respondents have nothing further to offer at this time, but we wish to have the time determined for the submission of findings of fact, or request for findings of fact.

The Examiner: Well, under the rules of practice, that is a matter for the Commission to pass upon, and I do not see any need for going into that here.

9503

Mr. Binford: Off the record.

(Discussion off the record.)

The Examiner: I want to inquire now of counsel for both sides if you are ready for this record to be formally closed?

Mr. Browning: Counsel for the Respondents are ready, subject to the various understandings into which we have entered, regarding corrections and furnishing these further exhibits, et cetera.

Mr. Binford: And counsel for the Commission are in accord with that respect.

9504

—7,313—

The Examiner: Very well, subject to the matters which are mentioned in the stipulation to be supplied at a later date, the record in this matter is now closed.

(Whereupon, the record was closed, as above.)

—7,314—

Oral Argument

9505

BEFORE THE

Securities and Exchange Commission

WASHINGTON, D. C.

Docket No. 59-10

IN THE MATTER

of

THE NORTH AMERICAN COMPANY, *et al.*

9506

Hearing Room 1102,
Securities and Exchange Commis-
sion Building,
Washington, D. C.,
Monday, June 2, 1941.

The above matter came on for oral argument at 2:30
o'clock, p. m.

Before:

EDWARD C. EICHER, Chairman,
ROBERT E. HEALY, Commissioner, and
SUMNER T. PIKE, Commissioner.

9507

Appearances:

S. PEARCE BROWNING, JR., and CHARLES S. HAMILTON, JR.,
of Sullivan & Cromwell, 48 Wall Street, New York,
New York, appearing for the Respondents.

RALPH C. BINFORD, appearing for the Securities and Ex-
change Commission.

9508

Argument of Ralph C. Binford

Chairman Eicher: Before beginning the argument, may it be stipulated by counsel for both sides that Commissioner Henderson, who cannot attend the oral argument this afternoon, may participate in the decision provided he reads the transcript of the argument?

Mr. Browning: Yes.

Mr. Binford: Yes.

Chairman Eicher: You may proceed, Mr. Binford.

9509

Argument of RALPH C. BINFORD, on behalf of the Securities and Exchange Commission.

Mr. Binford: As the Commission knows, this proceeding was initiated on March 8, 1940, for the purpose of determining what action The North American Company, a registered holding company, and its subsidiary registered holding companies and other subsidiaries, should take in order to limit their operations as required by Section 11(b)(1) of the Public Utility Holding Company Act.

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It was directed,—that is to say, the notice and order instituting the proceedings so stated,—not merely to restricting The North American Company in its operations, in accordance with Section 11(b)(1), but to the determination of what steps each sub-registered holding company within the system should take to limit the operations of such system in accordance with the provisions of the Act.

The North American Company filed an answer in which it tentatively took the position that it admittedly had sev-

Argument of Ralph C. Binford

9511

eral systems within the meaning of "integrated utility systems" under Section 2(a) (29) of the Act, and that it would select what it contended to be such a system existing in and around St. Louis, as its principal system, and would seek to retain a system operated by Cleveland Electric Illuminating Company in Northern Ohio, as an additional system.

However, shortly after hearings began—in fact, almost as soon as they began—before the Trial Examiner, upon a question of evidence which was brought before this Commission, The North American Company was permitted to amend its answer so as to provide that it was not committed to the proposed course of action suggested in its answer, the assertion being made that that was based upon the theory that it would be allowed to proceed without the continuance of these proceedings.

9512

Accordingly, no definite position has been taken by The North American Company nor by any of its subsidiary companies on this record up to May 23, when the requested findings of fact, and briefs in support thereof, were filed both by Commission counsel and by counsel for the respondents other than North American Light & Power Company and its subsidiaries, these latter having been permitted to retain additional counsel and having been granted additional time for filing of requested findings of fact and briefs in support thereof, in respect of the companies within that sub-holding

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company system, including the top sub-holding company, North American Light & Power.

Now the staff requested, by its requested findings of fact and by the briefs filed therewith on May 23, that the Com-

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Argument of Ralph C. Binford

mission find, in brief, that The North American Company's system proper, that is to say, excluding North American Light & Power Company and its subsidiaries, consisted of several, or rather included several, integrated electric utility systems within the meaning of the Act; first, one operating under the sub-holding company, Washington Railway & Electric Company, and through the operating companies, Braddock Light & Power Company and Potomac Electric Power Company, in the City of Washington and in adjacent areas in Maryland and in Virginia, which we considered to constitute a single integrated system.

9515

Secondly, the system of Cleveland Electric Illuminating Company, having its principal operations in the City of Cleveland, Ohio, but operating extensively throughout the Northern portion of that State.

Thirdly, the system operated by Wisconsin Electric Power Company, Wisconsin-Michigan Power Company, and Wisconsin Gas & Electric Company, in Wisconsin and in part of the Northern peninsula of Michigan.

9516

Fourthly, the electric utility system operated by Union Electric Company of Missouri and the subsidiary electric

—4—

utility companies of that company.

A similar division of systems is apparently recognized by counsel for the respondent.

Now the controversy, therefore, centers down to the propositions of what interests in other businesses might be retained by The North American Company in connection with the retention of any one of these electric utility systems as a principal system; and, to the determination of what combination of systems is possible among these several

Argument of Ralph C. Binford

9517

systems, under the Paragraphs (A), (B) and (C) standards of the Act; and to a third proposition, that is, as to what action must be taken by Washington Railway & Electric Company and by Union Electric Company of Missouri, which are both registered holding companies, to limit their subholding company systems in accordance with the Act by the elimination of businesses qualifying under the "reasonably incidental, or economically necessary or appropriate" clauses, or not qualifying as separate systems.

Two of these electric utility systems are operated to some degree in conjunction ~~with~~ gas businesses, gas utility businesses, within the meaning of the Act. The question of the retention of those by a holding company retaining the electric utility system is also presented by the argument and requested findings of respondent. 9518

No statement is made in the findings, nor in the brief, as to what system The North American Company wishes to retain as a principal system.

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Now it seems to us that the tests applied to "additional systems" necessarily presuppose a principal system to which such systems must be "additional", under which the tests given in the section upon which this proceeding is based may be applied. 9519

We have been given no indication of the position of The North American Company in that respect, but the argument is made that Cleveland—by which I mean the electric utility system operating in that City and adjacent parts of Ohio; the system operating in Wisconsin and the Northern peninsula of Michigan; and the system of Union Electric Company of Missouri, may all be retained in combination. As to which

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Argument of Ralph C. Binford

is to be considered the "principal" system, there is no statement, but the tests are applied as if that made no difference, or they are attempted to be applied.

It is also urged that each gas utility system presently operated in conjunction with the Wisconsin-Michigan system, and the Union Electric Company of Missouri system, may also be retained.

9521

It is stated that The North American Company is proceeding to dispose of the Washington Railway & Electric Company, and therefore the question of the permissibility of retention there is not in issue.

It is further urged that some investments in excess of

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\$40,000,000 in Detroit Edison, which is a statutory subsidiary of North American, and an investment of \$60,000,000 odd in Pacific Gas & Electric Company, may be retained as interests in businesses or as investments under the provisions of the Act.

Commissioner Healy: Now the Detroit Edison has been held to be a subsidiary—

9522

Mr. Binford: (Interposing) The action of this Commission in refusing to declare it to be otherwise has been, in effect, upheld by the Circuit Court of Appeals in dismissing the petition for review, but it is a subsidiary by virtue of the statute until declared to be otherwise.

Commissioner Healy: Is there any doubt about it being an operating utility company?

Mr. Binford: No, sir; by an order of this Commission and by consent of all counsel, the recent A-2 registration statement of the Detroit Edison Company was put in evi-

dence in this case, after the close of the taking of testimony before the Trial Examiner—

Commissioner Healy: (Interposing³) But the status of the Pacific Gas & Electric is in a little more uncertain condition, I believe?

Mr. Binford: That is in actual litigation. As to the Detroit Edison Company, until an appeal is taken, I believe it can be considered as settled.

Now most of the contentions, I believe, have been—or

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9524

some of the contentions at any rate, if not all—anticipated in the briefs filed in this case. I don't see that oral argument could add any great amount to them.

However, it is the position of the staff that no one of these great electric utility systems, controlled by The North American Company, can be held, in combination with any other, under the (A) and (C) standards of the Act, eliminating for the moment the problems incident to the several constructions heretofore urged upon this Commission in respect to paragraph (B) of Section 11.

This holding company system is unlike some others that may have come before the Commission, in that it has specialized, it would seem, in the control of great metropolitan systems—Washington, Cleveland, the metropolitan area of St. Louis, the area of Milwaukee, and a large system extending out and based upon the Milwaukee operations.

9525

Each of these systems, we submit,—and there are exhaustive discussions, of course, in the record, and figures given not only in the record but in the proposed findings of fact,—is a gigantic enterprise in and of itself.

9526

Argument of Ralph C. Binford

The combination of any two of them would certainly be such as to violate the provisions of both the (A) and (C) standards.

The North American Company put in evidence, over objection and subject to exception, a comparison of its size with the size of certain other industries. Those figures are possibly a little misleading, even if they had any relevance.

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They could hardly have relevance, it seems to me, although I was overruled by the Trial Examiner, until it was shown that these businesses of similar size were not impeded, or were aided in the efficiency of their operations by their size.

However, based upon Exhibit 143, and testimony appearing in the record relative to the Pacific Gas & Electric Company at page 7040, I would like to call the attention of the Commission to the size of this aggregation of assets controlled by The North American Company at the present time, which, by their theory of this case, they do not intend substantially to reduce.

9528

Now the companies consolidated on the basis of the method of consolidation used by the auditors of The North American Company, have assets of \$957,064,000. By their method of consolidation they do not take into account the assets and plant and property of companies of which they do not have 50 per cent. or more of interest, regardless of the fact of control.

If we include Washington Railway & Electric Company and its subsidiary companies in that computation; Detroit Edison Company; and Pacific Gas & Electric Company, we have here a holding company which controls assets of a book

value of considerably over \$2,000,000,000—in fact, of \$2,239,956,000, by computations based upon Exhibits put in this record by respondent. This is an enormous company, such an enormous aggregation and concentration of economic power, the very thing which has the potentialities of evil

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which this Act was designed to eliminate and cure.

All The North American Company here apparently proposes to do—and yet feels that it has complied with the Act—is to dispose of Washington Railway & Electric Company, 9530 and to dispose of its interest in North American Light & Power Company and the subsidiaries of that company.

We respectfully submit that this is wholly farcical and ridiculous as an interpretation of the Act.

Now as to retention of interests in additional businesses, there are one or two points which are brought up by the brief which I think were not anticipated in our brief, and which I might mention, but which are brought out in a memorandum for oral argument which I filed with the Commission this afternoon.

First, let me take up a special situation, slightly different 9531 in its legal problems involved from the others of the system.

Washington Railway & Electric Company is a holding company incorporated by special Act of the Congress of the United States, and that charter, which consists of the special Act, has been amended from time to time. By the so-called Unification Agreement of 1933, the transit systems here in Washington were brought together, and other changes were made in the existing public utility system—using “public utility” in the general sense here.

Washington Railway & Electric Company was specifically

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empowered to hold the stock of certain subsidiary companies. Among those was the Capital Transit Company, which operates the transportation facilities in the City of Washington.

9533 It is now urged that the granting of this corporate power by special Act of Congress removes the question of the retention of these independent transportation properties by Washington Railway & Electric Company from the jurisdiction of this Commission under Section 11(b)(1), and the general statutory principle of construction is presented that a special Act or an Act relating expressly to a certain situation, governs over a general Act applying to the whole field, of which this particular case is a part.

Commissioner Healy: Do you think that is true when the general Act is passed several years after the special Act?

9534 Mr. Binford: I not only think it is not true in that case, sir, but I think Acts of the regulatory type, such as the Public Utility Holding Company Act of 1935, are exceptions to the rule so expressed when the only conflict is with a charter purporting merely to grant corporate powers, which has been made in the form of a special Act.

I cite several cases in the memorandum on that subject, but one case in particular, although not a Federal case, I think brings out the point rather clearly.

The Citizens Bank & Trust Company, at Tampa, Florida, was incorporated by a special Act of the Legislature in 1895, and it was empowered to hold stock of other banks, expressly,

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by special Act of the Legislature.

Later, in 1917, a general regulatory statute was passed, regulating the conduct of banks, and among other things it provided that banks shouldn't own stock of other companies or of other banks.

However, in apparent reliance upon this special charter provision, and the principle enunciated by counsel for respondent in this case, the Citizens Bank & Trust Company proceeded to—

Chairman Eicher: (Interposing) I am sorry to interrupt, Mr. Binford, but we will take a five-minute recess in order that Commissioner Healy may receive a phone call. 9536

(Whereupon, a short recess was taken.)

Chairman Eicher: Proceed, Mr. Binford.

Mr. Binford: As I was saying, this Bank, incorporated by special Act of the Legislature, and by that Act empowered to hold stock of other banks, even after the passage of a later regulatory statute governing the whole field of bank operations in the State which prohibited one bank from acquiring the stock of another, proceeded, in apparent reliance upon the provisions of the earlier special Act, to acquire stock of another bank. 9537

The legality of that acquisition came before the Supreme Court of that State, and the Court held that in the field of the exercise of regulation, a regulatory power of a police

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power nature, a prior special charter did not exempt the institution to which it was granted from the provisions of the later regulatory statute, and therefore, in the cited case the acquisition or purported acquisition, in violation of a later general statute, even though apparently authorized

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Argument of Ralph C. Binford

by the special charter, was wholly void and illegal.

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The Court said, in the second syllabus by the Court:

“No principle is better cited than that a special charter to any corporation to engage in a business of a public or quasi public nature can not be set up as exempting the institution from that regulation by the state in the exercise of its police power which the public necessity demands.”

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I submit that that is directly in point in respect of the argument here advanced that the special charter of Washington Railway & Electric Company, by Act of Congress, exempts it from the later regulatory statute embodied in section 11(b) (1) of the Public Utility Holding Company Act.

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Upon the same Washington situation a further suggestion is made, apparently in the alternative, that if the first proposition isn't true, then, that we have a legislative determination by Congress that the retention of Capital Transit Company by the same holding company owning Potomac Electric Power Company and Braddock Light & Power Company, which latter companies own the electric utility assets of the system, is the retention of a business “reasonably incidental, or economically necessary or appropriate” within the meaning of section 11(b) (1) —

Commissioner Healy: (Interposing) Who advances that proposal?

Mr. Binford: That is advanced as an alternative proposal by counsel for the respondent.

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I find it difficult to follow, that an earlier charter grant, preceding a general regulatory statute, can be upheld as a

legislative finding of the existence of certain conditions prescribed by the later statute, when the policy of the later statute had not yet been formulated or put into the form of law. I don't think that argument is tenable, and I don't believe any logical analysis of it can make it appear to be tenable.

Commissioner Healy: When was the La Follette Act, which prohibited the control of local utility companies by holding companies, passed in Congress; do you know about that?

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Mr. Binford: Yes, that is to say in respect to ownership of 20 per cent. or more of the local utilities?

Commissioner Healy: Yes.

Mr. Binford: Well, I believe that the so-called enabling statute of 1933, that other statute being on the books at that time, did operate to permit the present setup to exist, but when the 1935 Act, our Public Utility Holding Company Act, came along, there was no exception of that kind made, and the District of Columbia was expressly designated as a "state" in the Public Utility Holding Company Act, and the utilities therein made subject to the same regulations as those situated in the "states" as popularly known.

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Now it has already been pointed out that in our brief there is only one employee in common between this traction system and the local electric utility system. The two are

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divorced in corporate form; there is some intermingling of equipment, but the operations of each are carried on by a different personnel, and they are of a different type.

Now there has been no showing that, for instance, the bonds of the system, guaranteed by Washington Railway &

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Argument of Ralph C. Binford

Electric, of the transit system, have any particularly higher credit rating or are better than the bonds not so guaranteed. There is no showing, in other words, that any necessity requires the preservation of common ownership in these two companies, but that need not be taken up further, it seems to me, in view of the treatment of it in the briefs.

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Now the argument on Paragraphs (A) and (C), relative to the retention of these several gigantic systems together, electric utility systems, is, I think, answered by looking at the maps of the systems in this case which are exhibits, the numerous maps, and the financial figures given with respect to each of them, their size and the extent of their operations is almost enough to raise doubt as to whether each in and of itself, if a definite line could be drawn somewhere, would not be so large and of such characteristics as to violate the (A) and (C) standards.

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Now as to the retention of the interests of The North American Company in Pacific Gas & Electric Company, and in the Detroit Edison Company, what this Commission said in the case of United Gas Improvement Company, File No. 59-6, Holding Company Act Release No. 2692, relative to

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interests in other businesses, and particularly in statutory subsidiaries, and in utilities which are not statutory subsidiaries, seems to apply in the present case.

The only argument advanced apparently, so far, for the retention of these two investments, if they can be regarded as investments, and if were held not to be a subsidiary eventually by the highest court, is that they give diversi-

fication of income and of holdings to The North American Company security holders.

Now that is an argument, it seems to me, which was addressed at length to Congress in the enactment of the Public Utility Holding Company Act, and whatever advantages may lie in diversification were weighed at that time, and the evils potential to such a holding company system as the present one, whether they become active or are merely potential, as I have said, were evidently found by Congress to be greater than any advantages of great diversification, and were rejected by the enactment of section 11(b)(1).

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So that argument, it seems to me, has been settled already.

There is no other argument advanced as to why these interests in other businesses—if they could be considered as such, which we do not admit—are “reasonably incidental or economically necessary or appropriate”.

Now the transportation properties in Wisconsin, part of

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which are operated directly by the electric utility companies there; and one of which, the largest of which, is operated as a separate company, wholly owned however in respect of securities, by Wisconsin Electric Power Company—that transportation company was set up in 1938 to segregate the transportation properties.

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It was a first step to the eventual divorcement of the transportation properties from the electric utility properties of that group of companies, operating the Wisconsin-Michigan system.

It is suggested for the first time in the brief filed in support of the requested findings of the respondent, that that

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Argument of Ralph C. Binford

may have been a recognition by this Commission, or a finding, that the retention of those fraction properties or transportation properties—they have become largely gasoline propelled rather than electrically propelled—constituted the retention of a “business reasonably incidental” and so on, that is to say, complying with the standards of section 11(b) (1).

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A glance at the record in that case, however, and the published findings and opinion, will show that the principal thing there was not the acquisition of securities of the new company, the transportation company, which was formed, but the segregation, and it certainly can not be argued that insistence upon such segregation, and as a first step therein the acquisition of the securities of the new company by the former owners of the property, namely Wisconsin Electric

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Power Company, constituted any definitive finding by this Commission that that condition could go on forever.

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A thing may tend toward the development of an integrated electric utility system obviously, which doesn't accomplish it in the first instance, but merely is a step in that direction and to bring about a situation where the actual divorcement of those properties, which should be divorced, can be made; and I think that is the only way in which the opinion of this Commission could be construed in that case, if it has any bearing on this case at all.

Now as to the gas systems. This Commission has already heard argument and reargument on the question of whether or not a gas utility system and an electric utility system, can constitute a single integrated system in view of the two definitions given in the Act, and has held that they

can not do so, the cases on which are cited in the briefs filed herein.

As to the retention of one business with the other in the same locality, the tests of "additional systems" may be applied if a holding company seeks to retain both.

There is a great deal of evidence in this record, presumably introduced by the respondent, to show that substantial economies are effected both in the St. Louis area and in the Wisconsin-Michigan area, by the combination of the operations of the gas utility companies with the electric utility operations in the use of common personnel, common office

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space, and a number of other physical respects.

However, this evidence is susceptible of other interpretations, it seems to me. It does not conclusively prove, nor substantially prove, that one business is not carrying the other. There is no detail of the basis of apportionment sufficient for this Commission to say that substantial economies are effected for the consumers or investors with respect to the gas businesses, or whether or not an extra burden is not being forced upon them, or vice versa, the latter being the more likely of the two situations.

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The question of whether such retention is desirable from the public viewpoint, or whether it is detrimental to the public interest, is still open. Both companies are, by their nature, usually monopolies in a given area. It seems to me highly questionable, in the absence of unusual circumstances which might exist in a particular case, whether or not the two competing—that is to some degree competing—utilities should be held under common control and common ownership rather than be operated as distinct properties, each by

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*Argument of S. Pearce Browning, Jr. and
Charles S. Hamilton, Jr.*

its energies and efficiencies of operation tending to stimulate the other to greater public service.

There is some evidence in this record tending to show that there is much greater activity, in promotion work presumably, in service by the gas utility people in the districts in which they do not also operate the electric utility businesses,

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and even in the absence of evidence of much weight on that point, it seems to me that the Commission, in view of situations recognized in numerous reports of state public utility commissions, and well known, can see that there are certain inherent disadvantages in such joint ownership which may be detrimental to the public interest; and I submit that that proposition, known officially and judicially to this Commission, is not overcome by the particular circumstances of joint utilization, to some extent, of personnel and of equipment in the present case.

I think that is all I have at the moment, although I would like to say something in reply after respondent's counsel has spoken.

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Chairman Eicher: Mr. Browning!

Argument of S. PEARCE BROWNING, JR., and CHAS S. HAMILTON, on behalf of the Respondent.

Mr. Browning: If the Commission please, at the outset I should like to clarify certain matters which may serve to simplify the argument.

In the first place, I should like to make it clear that we are not representing here today North American Light &

*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

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Power Company or its subsidiaries. We are representing all of the other subsidiaries of The North American Company.

Commissioner Healy: Are you representing the interests of North American in North American Light & Power? You own 85 per cent. of the common stock of that company,

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do you not?

Mr. Browning: Why, as far as we are concerned, Judge, North American Light & Power Company is going to be dissolved and its assets are going to be disposed of in liquidation. From a realistic standpoint, and looking forward, we think it is a waste of time to talk about the control of those companies. We haven't asked for any findings with regard to refutation by North American of its interest in those companies.

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Commissioner Healy: Are the assets of The North American Light & Power going to be distributed in accordance with the provisions of this Act and the applicable decisions of the Supreme Court of the United States?

Mr. Browning: Judge, I am not particularly familiar with the proceedings except that I know that a meeting of the stockholders of North American Light & Power Company has been called to consider and act upon its dissolution.

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Commissioner Healy: Well, since The North American Company has such overwhelming voting control of North American Light & Power, and since the statute and the applicable decisions have laid down certain rules in respect to the distribution of assets, it may still be a very live topic in this case, in fact I am inclined to think it is.

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*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

Maybe this isn't the appropriate time to discuss it, but for my part I should be very much loath to go along with the suggestion that the North American Light & Power problem goes out of this case completely merely because it is planned by The North American Company to dissolve North American Light & Power.

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Now, North American not only owns 85 per cent., and therefore the voting control of North American Light & Power, but it also has a large debt claim and a large position in the preferred stock of North American Light & Power.

Then there is a large public interest in the preferred stock, and in a minority of the common stock.

I have been very much concerned, in my thinking about this matter, as to just where those debt claims and preferred stock claims might stand in liquidation as against the publicly held preferred and the publicly held common stock, in the light of the Supreme Court's decisions in the Deep Rock Case and the Consolidated Rock Case, and possibly some of the obiter in the Pepper versus Linton Case.

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As I have said before, this may not be the appropriate time to discuss those details, but since there is a proceeding here which involves the North American Light & Power Company and its subsidiaries, and the interests of The North American Company in North American Light & Power, I have some reservations of the propriety, and perhaps the legality, of going off into the State courts for a liquidation of North American Light & Power while there is a case

pending before this Commission under our statutory authorities, which hasn't been decided, which, according to you,

*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

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ought not to be decided for some time; but the question in my mind is whether, pending that decision, a liquidation under a State statute is entirely an appropriate remedy. I don't see at all, at the moment at least, that the proposal of liquidation concludes the North American Light & Power Company and takes it out of this present proceeding, where North American Light & Power is a respondent.

Mr. Browning: Perhaps I can clarify that a bit.

I did not mean to say that you wouldn't have before you argument concerning North American Light & Power Company and its problems. I was trying to clarify this argument by saying that since, so far as North American was concerned, retention of its interest was no longer an issue, we saw no useful purpose to be served in discussing it, and I am not prepared to discuss the other questions which you mentioned.

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Commissioner Healy: Well, of course, how North American Light & Power might be disposed of in the present proceeding in which it is a respondent, hasn't been decided, and I am not entirely clear that the dissolution proceedings in the State court are an appropriate thing in this stage of the case. I just want to put that caveat in there so that our silence might not be taken as acquiescence.

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Mr. Browning: In the next place, we filed with the Commission today a reply brief which brief also serves as a brief

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on various legal questions involved.

In that brief we ask leave at various points to incorporate by reference the briefs of respondents' counsel in other

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*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

11(b)(1) proceedings, the U.G.I., the Engineers Public Service, and the Commonwealth and Southern.

The point was that we wanted to have it understood that we were making the contentions, and at the same time we didn't want to burden the Commission with reading the same arguments, and I would like to ask the Commission if we were correct in assuming that we would have leave to incorporate those by reference?

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Chairman Eicher: Does counsel for the Commission have any objection?

Mr. Binford: If that is done, I think, of course, in fairness, the briefs of counsel for the Commission in the same proceedings should also be open for consideration by the Commission.

Otherwise, we have no objection.

Mr. Browning: That is entirely satisfactory.

Chairman Eicher: That will be the understanding, then.

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Mr. Browning: And by the same reasoning, I have no intention today of rearguing the various detailed questions of statutory construction which you have heard in those other proceedings.

We understand that the Commission refuses to consider the constitutionality of the statute, so that there is no purpose to be served in discussing constitutional issues. I would like to have that clear on the record also, if I may.

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Commissioner Healy: Well, the Commission's decision, as I have understood it on that point, wasn't as much a matter of refusal, as a conclusion that we were not at liberty to

*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

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do it. That is the conclusion of the Commission as I understand its decisions.

Mr. Browning: What I meant, Judge, was that you would feel that there was no useful purpose in my arguing the constitutionality of section 11(b)(1).

Commissioner Healy: I think that that is consistent with the position that the Commission has taken.

Mr. Browning: Now, that leaves for consideration only the issues of statutory construction, and it seems to us that those are principally two: (1) the tests for other businesses and (2) the application of the (A), (B) and (C) standards in the present case.

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We also want to discuss quite briefly the problem of electric and gas facilities, without repeating all of the arguments which you have heard before; and, finally, the point concerning the election of a principal system.

As a matter of presentation, we would prefer, if the Commission please, to take up first the tests for other businesses, and consider the other matters later; and if the Commission will so permit, I should like to have my associate, Mr. Hamilton, discuss this test of other businesses as present in this case.

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Chairman Eicher: That will be quite agreeable.

Mr. Hamilton: For the sake of convenience, I would like to take these up, if I may, first of all with a brief discussion

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of what I understand your decision, in the U.G.L. Case to mean as applied to "other business"; and secondly, specifically taking that test up with respect to businesses conducted

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*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

directly by the four main groups in The North American System; and, finally, those owned or controlled directly by North American.

In referring to these groups I use the same terminology that has been used heretofore. The Washington group is the Washington Railway & Electric Company and its subsidiaries; the Cleveland group, the Cleveland Electric, and so on.

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Now, in the Commission's decision in the U.G.I. Case, Holding Company Act Release 2692, there are set up a number of clearly alternative tests which may be met in order to comply with the statutes on "incidental businesses".

The Commission in that case specifically said that the "Commission must permit the retention of other businesses, including investment interests in utilities not subsidiaries, which are found to be (one) reasonably incidental or (two) economically necessary or (three) appropriate to the operations of an integrated public utility system"—

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Commissioner Healy: (Interposing) What case was that?

Mr. Hamilton: The U.G.I. Case, Holding Company Act Release 2692.

The Commission went on to say that "as to both investments in non-utilities and interests in non-utilities sufficient to create the statutory parent-subsidiary relationship, these

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standards may be met if the retention of the investments or other interests is found to be (one) necessary or (two) appropriate in the public interest or for the protection of

*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

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investors or (and I am inserting words, interpolating for the protection of) consumers and (in each case) not detrimental to the proper functioning of such system or systems."

If you will notice, as to the second half of this statement by the Commission, there are set up here clearly six alternatives. It isn't necessary that five or all six be met, but that one out of the six be satisfied.

Now, what does the staff say on this point?

Counsel for the Commission in his brief refers in passing to the entire sentence to which I have just referred, and then says that "reasonably incidental" carries with it the connotation of a functional relationship. Then he takes up "economically necessary or appropriate", and he says that these words appearing in close juxtaposition must be given their obvious meaning of functional relationship.

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In other words, as he analyzes this test, there is only one test provided, and that is a test of "functional relationship", disregarding clearly the fact that there are three alternatives set up. He goes on to state or rather to cite a case, which is correct, to the effect that words used in a statute of Congress are to be given their known and ordinary signification.

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Now, what are the meanings of these words in their known and ordinary signification?

The word "incidental", as defined in the accepted dictionaries, means: casual, subordinate, occurring in connection with something else.

The word "appropriate", similarly is defined as meaning suitable, fit, or proper.

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*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

These definitions, in common and ordinary use, considerably broaden the test beyond one merely of functional relationship. It may well be that functional relationship has some bearing, but certain there are other criteria which similarly have bearing.

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For example, the question of a historical connection over a period of years on the question of whether a business is incidental; whether one might expect normally to find the particular type of business represented in a public utility enterprise.

I call the Commission's attention to a decision of the Circuit Court of Appeals in the Ninth District, 111 Fed. (2d) 1014, in which the Court was called upon to construe the phrase appearing in section 203(a) of the Federal Power Act, "consistent with the public interest".

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The Circuit Court of Appeals for the Ninth Circuit said that "the language employed ought to be construed to mean no more than it says. It is enough if the applicants show that the proposed merger is compatible with the public interest." In other words, the Court is interpreting the phrase

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"consistent with the public interest" to mean compatible with the public interest. The Court goes on to say:

"The Commission * * * may not impose a more burdensome requirement in the way of proof than that prescribed by law * * * suffice it to say that the statute does not require a showing that positive benefit to the public will result * * *"

I think that case should be borne in mind in any application of the term "appropriate in the public interest" appearing in this section.

*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

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Applying that case to the present instance, it is not necessary that there be shown from the record evidence to establish that positive public benefit will result by reason of the retention of the particular business in the enterprise. Rather, on the other hand, that the retention of the business in the enterprise shall merely be compatible or consistent with the public interest.

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Now turning to the specific incidental businesses which are represented in these four groups, we have, in the case of three groups, a steam heating business, which counsel concedes meets the statutory tests, and which therefore I shall not discuss.

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Also, a land business in the case of the Union group, which, in addition, he concedes to meet the tests, and which, similarly, I shall not discuss.

Transportation businesses in certain of the groups, and electric railroad business in the Union group; a coal business in the Union group; and an electric furnace manufacturing company in the Wisconsin group.

Turning specifically to the transportation businesses—and here I don't propose to take up each one in detail—the facts with respect to the operations of each transportation business are set forth in the proposed findings and in our main brief.

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But taking them up simply for the purposes of illustrating the point in the application of the statute—the Capital Transit here in the District has, for 48 years, directly or indirectly, been operated in conjunction with Washington Railway & Electric Company. Washington Railway was

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*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

organized in 1892, and at that time the railroad business predominated, and the electric business was more or less incidental.

That has been, I think, the history of a number of the present electric utilities in this country. Originally they

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were transportation companies.

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This business, as now constituted, is a revenue-producing investment for Washington Railway & Electric Company. The joint operation is indicated by the fact and to the extent that joint use of equipment is made, and also by the fact that Capital Transit is a very large purchaser of power from the Potomac Electric.

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Now as to whether this business is incidental, the value of the investment as per the books of the Washington Railway & Electric Company is approximately 15 per cent. of the total consolidated assets, based on carrying value. The income from the investment is approximately 2 per cent. of the consolidated income. However, relating the carrying value of that investment to actual present market value, the investment is worth approximately, or represents approximately, 2 or 3 per cent. of Washington's consolidated assets.

Now as to whether or not the business is appropriate, it seems to me that the Commission should clearly bear in mind the fact that there is no requirement, or should be no requirement, that an affirmative public benefit will be shown to ensue from retention of the ownership. Rather, as I have pointed out before, the question is: Is it merely compatible in the public interest that this business be retained?

*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

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Now counsel has mentioned a point made in the brief as to the operation of the joint resolution, so-called, of 1933,

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on the ownership by Washington Railway of its stock interest. Whatever the case under the Florida courts, the Supreme Court has clearly laid down the rule of statutory construction, that a later general statute which is not, on its face, irreconcilable with a prior specific statute, or is not on its face wholly inconsistent or incompatible with it, does not constitute a repealer of the prior statute; and I refer in that instance to certain cases in the Supreme Court, three in number which are cited in our main brief.

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Without attempting to go into detail on his analysis of the case on which he appears to place the most reliance, because his brief has just been furnished to us—as ours to him—at the opening of this argument, as I understand his analysis, the Florida case merely holds that a later statute which specifically repeals a charter provision created by law previously is a proper exercise of the State's police power.

Now here the Public Utility Holding Company Act of 1935 does not expressly repeal prior enactments. It is not, on its fact, wholly inconsistent with the prior statute of 1933 authorizing retention of the stock interest.

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I ask the Commission to refer to those cases, and to read the Supreme Court's statement on statutory construction.

Turning now to another transportation business, the Milwaukee Electric Railway & Transport Company,—to which I shall refer, in shorthand expression, as the Transport Company—this business in Milwaukee has been conducted for

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*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

51 years, since 1890, either directly or indirectly in conjunction or control or with the electric utility operations.

Here again, originally the properties in Milwaukee, the utility properties, were street railway properties. Gradually, with the growth of the electric business, a shift in economic circumstances, the incidence of the importance of the operations has changed, and here again predominantly it is now an electric utility company, and the transport operations are relatively minor.

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Now as to why the segregation occurred in 1938, the fact is that market-wise a public utility bond is a more saleable vehicle than a bond which is a lien on property both of the electric property and of transportation operations. That was the reason for the segregation in 1938, to permit and to facilitate a major refinancing which occurred at that time.

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Now the record is replete with evidence showing the essentially joint nature of this operation, and here again I refer you to our findings and to our brief, which take these facts up in detail, and which establish, in my judgment beyond any question, that the business is not only incidental, by reason of the combined nature of the enterprise, but that it is also entirely appropriate because of manifest economies which result from the combined operations.

In addition, the transport company is the purchaser of approximately 100,000,000 kilowatt hours a year, at a rather low rate of 7.8 mills.

Certainly it seems to me that retention of this interest is appropriate in the public interest, as it has been for 51

*Argument of S. Pearce Browning, Jr., and
Charles S. Hamilton, Jr.*

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years, and in the interest of investors and consumers. Certainly that property, if sold on the auction block today, is going to represent to Wisconsin Electric a very substantial loss, and therefore, in that respect, the interest of investors in Wisconsin Electric Power bonds, preferred stock and common stock, is involved.

Taking up again, for purposes of illustration, the business conducted by the Union Colliery Company, in conjunction with the St. Louis group, this business again has been part of the Union group since 1917. In other words, it has been a parallel operation for a period of 24 years, and I might say in passing that I note, in counsel's reply brief, that he indicates that neither in this case, Union Colliery, nor in the case of St. Louis & Belleville Electric Railway Company, have we made any contentions. I refer him specifically to pages 34 and 36 of our brief, where we most surely do make some contentions.

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Commissioner Healy: May I interrupt just a moment on this Wisconsin street railway situation? Is that being operated at a profit or at a loss?

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Mr. Hamilton: The net income before bond interest in 1940 was approximately \$630,000. That is after depreciation.

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After bond interest of \$400,000, the net income transferred to surplus would have been about \$230,000.

I might say that that is, as you know—and I imagine this is generally true of other transportation operations—not a tremendously profitable enterprise. It is a case of working out, over a long period of years, an investment which, by force of economic circumstances, is not as attractive now as

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it was back in 1910. That is peculiar, I think, to most of these transportation operations.

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As to Union Colliery Company, this is a coal mining enterprise located some 85 miles from St. Louis, 80 per cent. of whose production is sold to the Union group for consumption in its steam generating plants. Almost the entire requirements of the Union group, of coal, are purchased from Union Colliery Company. It is important to Union for a number of reasons: One, the coal is entirely satisfactory for Union's steam generating facilities; two, Union, as you know, has a very substantial amount of hydro generation. That results in a circumstance where, at times during the year, due to high water or to the impoundage of water at the Osage Dam, it is possible to cut down on the steam generation. Therefore, an available source of coal from an affiliated company, where it is possible to get delivery when needed, is an important part of the Union enterprise. It contributes to the efficiency of the operation of the Union group.

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Now as to the size of the Union Colliery Company, on plant account and on revenues, it is approximately 1½ per cent. of the total in the Union Group.

Commissioner Healy: Does the Colliery Company sell coal to anybody else?

Mr. Hamilton: Yes, it sells 20 per cent. of its output, as of June 30, 1940, the 12 months' period, to outside sources.

Now I might point out in this connection that the Commission in 1937, at the same time that it approved the reorganization of the Union Company, the consolidation of the

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five East Side subsidiaries, specifically approved the transfer of this Colliery stock from Union of Missouri direct to Union of Illinois, and in that connection the Commission's findings and opinion stated:

"In the present case the Colliery is already owned within the system and its transfer from an intermediate holding company to the company which is to become the owner of the principal generating plants which it serves, will tend towards the economic and efficient development of an integrated public utility system".

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I think the Commission has already passed on this phase of the case in 1937.

Commissioner Healy: Can you conceive of our making a finding under 10(c) (2) of that character where the real basis for saying it was to get the property into a position where it could be readily disposed of if it were found not

—37—

to be retainable under 11(b) (1)?

Mr. Hamilton: Judge, I don't want to push the point too much, because it may be embarrassing, but it seems to me that there were necessarily involved in a consideration of any transfer of ownership of securities within the system, or any acquisition of property, back in 1937 and 1938, necessarily in the Commission's mind there must have been a consideration of Section 11(b) (1). Now this is the language of your opinion.

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Commissioner Healy: Well, of course, the various companies are in here many times with cases where we are asked to approve transfers under 10(c) (2); where it seems pretty plain that when this thing is all sugared off, some of these

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companies cannot be retained. But it quite often happens that it works in the direction of simplification, and also gets the property involved to a place where it can be more readily handled under 11(b)(1). I am not sure that if we make too strict an application of the 10(c)(2) standards, that we may not find ourselves where we cannot approve a good many transfers of that kind which have immediate benefits or immediate tendencies in the 11(b)(1) direction, but which in the long run can't be held under 11(b)(1).

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Mr. Hamilton: I think you are quite right in that case, for other reasons, too. I think, on the merits, the business is entirely proper under the statutory tests, irrespective of

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the language you may have used in your opinion.

Commissioner Healy: That may be so, but I just raised the question as to whether the language in the opinion necessarily concludes that point.

Chairman Eicher: That approval occurred in 1937?

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Mr. Hamilton: Right.

Chairman Eicher: That was prior to January 1, 1938, when, for the first time, the Commission took affirmative action looking towards the enforcement of Section 11?

Mr. Hamilton: That is true.

Now I have used these specific instances not for the purpose of exhausting the argument, but simply to point out the application of what seemed to me to be clear alternatives under this section of Section 11(b)(1), to specific incidental businesses in the system.

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Now as to the facts involving the other businesses, as to our contentions, I don't think it is necessary to repeat what is already in the main brief or the findings.

Now turning for the moment to the businesses controlled directly by North American, as distinguished from those which are controlled within the subsidiary groups, these investments and businesses are made up of an office building corporation in New York called Sixty Broadway Building Corporation; West Kentucky Coal Company, and its subsidiaries, a producer and distributor of coal in Kentucky; North American Utilities Securities, a relatively inactive, almost completely inactive I might say, investment company; and the stock interest in Detroit Edison and Pacific Gas & Electric.

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In order to meet to some extent these assertions of tremendous size with which counsel has characterized these investments, let me give you a few facts.

The investment in Detroit Edison is not \$40,000,000, but actually \$29,800,000, which is before deduction of the dividends recently declared, subject to your approval, payable on North American common stock.

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Now the Act itself specifically contemplates the existence of a holding company. Otherwise, the provisions relating to control of an integrated public utility system, or of other businesses, would have no effect. Detroit Edison and Pacific Gas & Electric we maintain represent investments.

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I have in mind the decision of the Circuit Court of Appeals denying a petition for review of this Commission's order. However, there has been no final determination of

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that case, in the event an appeal is taken, and whether or not one is to be taken I do not know; and in addition to that fact, and as a further argument to support our contention that this is in fact an investment, I point again to the action of North American in declaring this dividend payable in Detroit Edison stock, which would have the effect of reducing North American's holdings from 19.21 per cent. of voting stock to 16.78 per cent.

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Now here again I don't want to exhaust your patience with a detailed statement of the facts, or an attempt to apply, in each case, the statute to the specific business or investment. I want to illustrate by taking one or two.

First, as applied to the Sixty Broadway Building Corporation—this company owns as its sole asset a 25-story office building in New York City, of which two floors, and part of three others, are devoted directly to North American's activities. The total assets of this enterprise are approximately 1 per cent. of North American's corporate assets.

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The record shows, through testimony, that in the early 30's and in the late 20's this investment was of extreme importance because at that time rents were high in the New York financial district. The return on the investment at that time was high, and the saving in terms of rents paid was substantial to North American.

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Even in 1940 this investment produced income of 21½ per cent. on its carrying value to North American.

The testimony in the record shows clearly that this business can not be sold at this time, the office building, without recognizing a substantial loss.

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If we assume, as I think we must, that continuation of a holding company is proper under the Act, and is clearly so from the language of the statute, certainly any holding company should be permitted office space for its operations.

Commissioner Healy: How much of the building does The North American Company itself occupy?

Mr. Hamilton: Two floors, and part of three others, out of a total of 25. You won't find many small buildings down there though, Judge.

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Commissioner Healy: I suspect not.

Mr. Hamilton: Now I think, just in passing, that the amount of this investment is, on its face, so small, and its purpose in providing office space essential, and that is its main purpose—

Commissioner Healy: (Interposing) What is the investment in the building?

—Mr. Hamilton: The stock is carried at \$350,000 on North American's books. There is an open account which, as I remember, is of the order of \$1,600,000.

Commissioner Healy: Is that the cost of the investment to

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North American?

Mr. Hamilton: That is the cost to North American.

As to the Detroit Edison—and I pick this as an illustration of the two utility investments—as the Commission knows, this investment dates back in its origin to 1903. It represents today less than 10 per cent. of North American's corporate assets, and approximately 7½ per cent. of its corporate gross income.

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As pointed out in the brief, this investment, together with Pacific Gas, provides diversity and stability of income.

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The record shows that in the five-year period 1936 to 1940, inclusive, the dividends from these two sources have more than covered North American debenture interest and preferred stock dividends in the three years, namely 1936 through 1938, and it covered 85 per cent. of the combined requirements, the amount of such requirements being larger by reason of the dissolution of North American Edison in 1938.

In addition, the records show that the Detroit Edison has been a valuable source of information in the inter-company committees, and that this information has been exchanged with other companies, Cleveland, Potomac, St. Louis and Wisconsin, for many years.

Now I would like to call your attention, in closing, to the Commission's decision in the American Water Works case in 1937, not as applied to the question of joint ownership of gas and electricity, however.

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In that case, which is Holding Company Act Release 949, the Commission expressly authorized the retention by American Water Works of subsidiaries conducting water businesses, constituting 30 per cent. of the total business of the holding company system, and in its opinion stressed the fact that these water businesses contributed a stable source of revenue to the holding company.

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Also, in passing on a coal business and transportation businesses, the Commission stated, as to the coal business,

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that it would "seem to bear an intimate relation to the operations of the gas and electric utility companies"; and as to the electric railway, bus transportation and bridge businesses, the Commission stated that it "realizes that these are in the nature of an inheritance from an earlier age when electric transportation was of more importance than the business of electrical distribution. In view of the facts and of the minor importance of the applicant's interests in these businesses, relative to its other operations, and in consideration of the difficulty which the applicant would face in satisfactorily disposing of its interests in these transportation businesses, the Commission finds that their retention is necessary and appropriate in the public interest and is not presently detrimental to the proper functioning of the applicant's integrated public utility system."

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We submit that that decision was well reasoned, that it was realistic, that it took into the account the problems which face the holding company under the Act, and we submit that it should be followed in this case.

Mr. Browning: If the Commission please, we should like to turn now briefly to the question of whether gas and electric properties may, in combination, constitute a single integrated system.

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The only gas properties in the main group of North American subsidiaries are in St. Louis and Wisconsin, and in the aggregate they amount to about 4 per cent. of the three-system total.

Our fundamental contention, as to the rule, which is a sound proper rule, is that as a matter of law gas and electric

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facilities may constitute a single integrated system but that whether they do in fact should be resolved upon the facts, and that is the point that I want to make today.

I thought that the question was thoroughly argued in the U.G.I. Case, but my only trouble was that it was being argued in a vacuum of facts. We want you to look at the facts in the North American Case as a background for a reconsideration of that ruling.

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In that connection, we hope that you are going to read our briefs, because we are not trying to cover today all of the items covered in our briefs. They are not long, we tried to hold them so that you could read them.

Counsel in his oral argument implied that there was no evidence on substantial economies. There is not only evidence but it is highly specific. We gave figures on these economies and those figures have never been challenged. And there isn't a scintilla of evidence in the record against that testimony, and we ask again that the Commission consider the facts in this regard.

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Turning now to the (A), (B) and (C) standards of section 11(b)(1), we wish to discuss those as applied to the

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St. Louis, Wisconsin and Cleveland groups, that is, whether, in combination, those groups meet the statutory standards.

Each one of the groups has been conceded to be a single integrated system in and of itself, as must have been the case.

Taking up the (A) standard, the test prescribed by the statute is that "each of such additional systems cannot be operated as an independent system without the loss of sub-

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stantial economies which can be secured by the retention of control by such holding company of such system".

Now the staff in its brief makes the contention that each of the three systems is large enough to stand on its own feet. In fact, that is the contention that the staff makes. That is not the statutory test. The statutory test is whether the substantial economies are derived by the subsidiaries. We discuss this matter in our reply brief, and particularly what seems to us to be the only question of construction involved, and that is the word "substantial".

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As far as I know, this particular issue of statutory construction has not been previously argued before the Commission. We have cited to you various cases dealing with the meaning of the word "substantial", and I just want to quote one judicial interpretation:

"'Substantial' as an adjective means something worthwhile as distinguished from something without value, or merely nominal."

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I would also like to refer to this Commission's own decision in the matter of Public Service Company of Oklahoma, where you were dealing with the correct interpretation of the word "material" under another section of the Act, and in which you said:

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"We think that the standard * * * connotes income the loss of which would be something more than de minimis to the company concerned."

In other words, we submit that, broadly speaking, the term "substantial" means something worth having, as distinguished from something nominal or de minimis.

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Now, our evidence in this proceeding goes much further. We have offered evidence in this proceeding, having placed upon the stand the chief executive of each of the subsidiary companies, and that evidence is conclusive, that these subsidiaries do derive substantial benefits from their retention within the North American system.

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Broadly speaking, these benefits may be divided into two classes: (1) the benefits which they derive directly from their contracts with The North American Company and (2) the benefits which they derive from their contracts with the sister operating companies.

Now, as to North American's direct benefits, as you know, the general theory of North American management for many years, since at least prior to 1920, has been a highly localized management, and that meant that North American's function was restricted to that of advice and consultation.

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The testimony is unanimous that that advice and consultation has been of great value to the subsidiary companies. Advice and helpful advice on one important matter may be worth advice on a thousand minor points.

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The advice is made valuable, and in fact the essential elements in it are: first, the background of knowledge of the holding company executives, of the particular operating subsidiary; secondly, the holding company executives' experience with a similar problem in other companies; and finally, and most vital of all, the factor of financial interest.

As Dr. McClellan remarked, when he was on the stand, he could get a lot of advice from anybody in the world on

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anything, but the advice that was worth having was the advice from somebody who had the same financial stake that he had.

Let me give an example of one important piece of advice. The Wisconsin executive testified that when Wisconsin was issuing bonds in 1930, Edwin Gruhl, who was then president of The North American Company, persuaded Wisconsin that they should issue more bonds than they then had in mind, should secure more money. That advice paid the Wisconsin hundreds of thousands of dollars, and permitted them to build the great Port Washington plant, because they could never have secured the funds in the depression.

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Commissioner Healy: Were they publicly held securities in those companies?

Mr. Browning: Yes, sir.

Commissioner Healy: Why didn't The North American Company make an equity contribution?

Mr. Browning: North American has made equity contributions totaling many millions of dollars.

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Commissioner Healy: What was the coupon on those bonds?

Mr. Hamilton: Five per cent.

Commissioner Healy: What was the rate of return being made on the investment and allowed by the Wisconsin Commission?

Mr. Hamilton: There was no dividend paid from 1932 until 1939, I believe it was, on the common stock of Wisconsin Electric Power Company, which was then Milwaukee Electric Railway & Light.

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Commissioner Healy: Did the common stock have earnings during that period?

Mr. Hamilton: My recollection is that it did for the entire period.

Mr. Browning: While that is being looked up may I proceed?

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Another example which is in the evidence is that the Cleveland company's decision to follow the growth of the Cleveland radius, in other words to expand its operations beyond the then narrow corporate limits of the City of Cleveland, was a direct result of North American's encouragement. That expansion has brought benefits to the public which I don't know that we could estimate in figures. The testimony in this record shows that as the Cleveland Company expanded its operations, rates were cut overnight more than half for those consumers. They got service they never dreamed of before.

No single action that I could think of has meant more to

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the people of that area than that expansion of the Cleveland Company's service area. My recollection is that those rates dropped from as high as 15 cents a kilowatt hour to five cents; and 12-hour service became 24-hour service.

Now the particular field in which The North American has aided its subsidiaries, one field in which it has rendered great assistance, has been in financing.

In our briefs we have pointed out the essential difference between a utility business and other businesses, in its constant need for new money. The utility business is distinct in that regard, as you know. Not only do they need money

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constantly, but they need a great deal of it, and financing problems are extremely intricate.

The witnesses testified in detail as to this, and also that despite the importance of the problem, as a practical matter, an operating utility executive does not have time or the opportunity to be a financing expert, he can not be both. None of these North American subsidiaries have found it necessary to maintain a financing staff. Furthermore, their testimony shows that if they did, the staff would not have the practice—they can't.

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Take a company like Cleveland, a great company, Cleveland does not finance every year, but only every several years. If Cleveland had a financing staff, that staff wouldn't get the practice that the North American staff does.

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The subsidiaries have not only saved the operating expenses to which they would have been subjected had they attempted to maintain a staff of anything like the same quality and caliber, but they have obtained much better results.

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In fact, witnesses attributed the unusual operating results of The North American subsidiaries to be in substantial part due to their freedom to devote their attention to operating problems, as distinct from financing problems.

Now let us turn to the sister company contacts. The testimony shows that beginning in 1921, under North American's sponsorship, there were set up these committees of engineers from the operating companies. There were two such committees, one dealing with all phases of power generation, and the other dealing with all phases of power trans-

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mission and distribution. Those committees have functioned over the years, they have been highly important, they have had remarkable results which have been reflected in the operations of the respective companies.

In effect, the result has been an engineering pool, giving each company the value of the consulting engineering services of the other companies.

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You know, from your own general knowledge of the utility industry in this country, how important it would be for a company in a metropolitan center to have the detailed aid of engineers from other metropolitan centers. There is no such group anywhere else in this country as these North American committees.

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We offered in evidence, as our Exhibits 131 and 132, specimen minutes of these committees. We brought down all the minutes over the years. They filled suitcases. And we just offered a specimen. Then we said to the staff, "If you don't think this is a fair specimen, you pick your specimen" and we left the minutes with the staff. I gather that they thought we had picked a fair one, because they didn't offer any.

The minutes were too long to quote in the brief, so we only have a very short excerpt. I wish you would glance at those minutes. You will be impressed at the variety and importance of the topics considered. They show on their face the tremendous value of the work of these committees.

Now more recently, a similar accounting committee has been formed. As you know, accounting problems have been getting steadily more important, and this is also functioning

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now. The executives of the sister companies are also in contact.

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Then there is another element, intangible if you like, but nonetheless real, and that is the competitive rivalry between these companies. They exchange the most detailed cost statistics regularly, and by the "most detailed", I mean right down to the last cent on everything.

They not only do that, but the chemists of each company analyze the coal of each other company to be sure that they are getting a fair comparison. Adjustments are made to make comparisons fair. As you know, the great difficulty in comparative statistics is to get a base that everybody will accept and say is a fair comparison. Having gotten this fair basis, then these elaborate and detailed statistics are exchanged monthly between the operating companies and, as one witness testified, Mr. Crawford, the President of Cleveland, it was like the standings in the American Baseball League. When those sheets came in, they showed how Cleveland stood as contrasted with the other companies. And each of the presidents have testified to this remarkable rivalry which exists between these companies. That rivalry has absolutely no counterpart elsewhere. In no other utility companies do we know of such feeling toward a non-affiliated company. It is a family relationship that produces it.

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Now the suggestion was made during the course of the hearings that all of the system relationships might continue if you terminated the system. We think that that suggestion is absurd on its face.

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The testimony shows that this exists only within the system. I might further say that the testimony shows that

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one company which retired from the system committees retired when financial control passed.

So that if you break up this system, you are going to break up something very fine and very valuable, and something which has been beneficial to the public, to consumers and to investors.

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Turning now to the (B) standard, we realize that this has been fully argued before the Commission, with all the legislative precedents and construction questions, and we have no desire to repeat those arguments. Our contention is that in any case the three systems here meet the (B) standard test, because they are in adjoining States.

Commissioner Healy: Adjoining what?

Mr. Browning: Adjoining each other, Judge.

If you take Union as your principal system, you have Union in Iowa, Missouri and Illinois, with Wisconsin adjoining, Michigan adjoining and Ohio adjoining. You have met the statutory test. If you take Cleveland as the principal system, you reach the same result.

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Commissioner Healy: What State does Ohio adjoin?

Mr. Browning: Michigan.

Chairman Eicher: On that theory, you could run a shoe-

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string clear across the United States, couldn't you?

Mr. Browning: I don't think that you can construe this statute in a vacuum. If you will look at the Federal Power Commission maps of the utilities in this country, it is perfectly clear that that question doesn't arise. We meet the statutory test, we are in adjoining States.

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Charles S. Hamilton, Jr.*

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Turning to the (C) standard, the so-called size standard—

Commissioner Healy (Interposing): Just a minute, before you leave that.

Suppose you took Cleveland as your principal system. On what basis do you contend that Illinois adjoins the State of Ohio, or Missouri or Kansas?

Mr. Browning: Off the record.

(Off the record discussion.)

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Commissioner Healy: You own property in Kansas?

Mr. Browning: We are not arguing for retention of that as a matter of statutory construction.

Commissioner Healy: Let's take your Union property in Missouri.

Mr. Browning: Could I just clarify that for one minute? Our constitutional case stands with respect to all properties. On the other hand, in discussing these issues of statutory construction, we are only dealing with three systems, Cleveland, Union and Wisconsin.

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Commissioner Healy: All right. Now let's take Union.

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How does the Union property in Missouri, how can it be said to be adjoining Ohio if Cleveland were selected as your principal system; how could you work that out?

Mr. Browning: Because there is nothing in the statute except the word "adjoining". Wisconsin adjoins Illinois—we have properties in Wisconsin; Michigan adjoins Wisconsin—we have properties in Michigan, in the northern peninsula there; and we have properties in Ohio which adjoin Michigan.

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Commissioner Healy: That is, you work out your connection between Cleveland and Missouri by saying that you have something in Michigan and Michigan adjoins Ohio?

Mr. Browning: Yes, sir.

Commissioner Healy: And you have something in Wisconsin, and Wisconsin adjoins Michigan?

Mr. Browning: Yes, sir.

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Commissioner Healy: And you have something in Illinois, and Illinois adjoins Wisconsin; and you have something in Missouri, and Missouri adjoins Illinois—is that it?

Mr. Browning: Yes.

Turning to the (C) standard, the question is one of size, or how big is "too big"?

Now I find Commission's counsel's discussion of this no less than remarkable. It is a masterpiece of generality—so was his oral argument today.

In other words, he says, "This system is too big". That

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is all. How do we know it is too big? What is the test?

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Commissioner Healy: Well, the burden is on you under (C) to show that each one of these additional integrated systems is not too big.

Mr. Browning: Yes, sir, and we have met that burden.

Now when I was at law school, one of the very noted law professors there used to talk about visceral logic. I don't think that we ought to go on that in this case; in other words, on a mere feeling.

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I think we ought to apply these tests, and that is what we have done in our brief, we did apply the tests.

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Charles S. Hamilton, Jr.*

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The Commission's staff makes no effort whatsoever, they never mention the three tests in (C). Their brief just says it is "too big".

Let's look at these tests right now.

The first is "not so large * * * as to impair the advantages of localized management",—and of course we are now talking about the combination. There is no question but that each of those groups has had localized management, for many years, long before this statute was ever passed, long before this Commission was ever established. That was the policy of North American as its own policy, and it followed it.

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Those systems have had every advantage of localized management. They couldn't have had more. Obviously the combination has not injured the localized management.

Now, in that connection I want to mention one thing: Counsel in his brief made a slighting reference to the Union situation which developed sometime ago. I want to say on that, that while we are not trying the Union Case here, the trouble was certainly not lack of localized management. The trouble was the opposite, the management was too localized.

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Furthermore, while that situation was most regrettable, what organization do any of us know, public or private, which can point with pride to every act of all its employees and ex-employees? Even the finest groups—and we believe

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The North American is a fine company with a fine record—have some troubles over a period of 50 years.

The important thing is that when those troubles arose, North American removed that management and put in a

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highly competent and new management which was a feat in itself.

Turning now to the test of efficient operation in standard (C), the evidence shows conclusively that not only are these three systems efficient, but they are outstanding leaders of their industry.

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St. Louis is a remarkable combination of a hydro-electric and steam combination, and I hope you will read the figures. They have a remarkable record for operating expenses, low rates, and fine service.

As to Cleveland, you know, sitting on this Commission, that it is ranked as one of the finest electric utilities in the United States.

You know that in its 1940 financing, it received the lowest rate ever obtained by an American utility up to that time.

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Then let's go to Wisconsin. Wisconsin is the only company ever to have won both Coffin awards for distinguished service in the electric and transportation fields. For any years it has had the most efficient power generation in the world, not only in the United States but in the world.

It was the original developer of powdered fuel, which has

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saved untold millions of dollars for the utility industry of this country and for consumers. And I may say that its development of powdered fuel was a remarkable illustration of courage and vision, not only on its part but on the part of North American, because at the time it was developed all of the experts were saying that it couldn't be done, and they invested millions of dollars in that powdered fuel plant, when the experts said it couldn't be done.

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Charles S. Hamilton, Jr.*

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Any person who knows the utility industry knows of Milwaukee's outstanding technical reputation.

Now, obviously, the combination has not injured efficient operation.

And let me show you how the combination helped. Take this powdered fuel, an outstanding, pioneering achievement in the utility industry, first developed in Milwaukee.

What happened next? The second plant in the country to have powdered fuel was at St. Louis, and there were further refinements and developments. The Wisconsin engineers were down there working to help them, and watching. In other words, the first invention was made, and then it developed within the system.

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Then we come to effectiveness of regulation. Now each of these three systems is regulated in all phases of its business by the respective State commissions.

The testimony is conclusive that they have been effectively regulated, and among other matters that all affiliate

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relations are regulated. We submit that it is impossible for the combination to injure the effectiveness of regulation, that it has not and cannot.

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As to size generally, we have shown by the evidence, which is reviewed in our briefs that this North American three-system combination is smaller than various single systems in the United States, both private and Governmental, and smaller on all tests. We took them all, square miles, kilowatt hours generated, generating capacity, revenue, assets—what you will. Of course, on the square mile test alone, Commission counsel has conceded that the Kansas Power & Light

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Company is a single integrated system and its square mileage is greater than the three systems combined.

Now we also show that this three-system combination was smaller than other leading American businesses.

One characteristic of America is that we are big here. In South America they refer to us as "El colosal del Norte". That is our common name. We are big, everything is big in the United States. We don't have 50 telephones, we have
9665 1,000. We don't have one automobile for every ten persons, but one automobile for every other person.

The South Americans think that that is remarkable, that we should be so big. But we are used to being big.

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Now this system combination is a big system, but it is not big in comparison with other leaders in American industry. The staff has stressed the distance from the New York office. I frankly can't see what that has to do with the case. Suppose we change the office to Chicago overnight. As you know, distance is shortening all the time. Think of the situation now as contrasted with that 10 years ago. Think of
9666 the improvement in transportation and communication facilities. And we have seen nothing as yet, because those distances are going to shorten still.

I can reach anybody on the telephone in Cleveland in as short a time as I could reach somebody in the next block.

We have also offered in evidence the report of a distinguished economist, showing that the Middle West constitutes a widely acknowledge region. All economists acknowledge it as a region in itself. In other words, these three systems

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are all located in one economic region. We submit that that is a highly significant factor which this Commission should consider.

Now if I may, I should like to turn to the last issue of Construction, which is the election of the principal system, and counsel has mentioned the fact that neither in the findings nor the brief have we elected a principal system.

The only statutory mandate is that each holding company shall limit its operations to a single integrated system and to permissible other businesses in secondary systems. The Act does not require that the holding company designate

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which of the systems shall be the principal system, and no such additional requirement can be added to the statute.

Now I am not fencing with words at this point, because the point is very material to North American.

Since the construction issues here concern three concededly integrated systems, and only three, St. Louis, Wisconsin and Cleveland, if the Commission should overrule our contention that all three may be retained, then North American should have the right to dispose of its interests in any such groups as circumstances permit. That is a highly important right, because we wouldn't know in advance, any more than the Commission would, what the circumstances regarding sale would be. That right is of great value to North American, and we insist that it is not called upon to designate a principal system under the facts of this case.

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Commissioner Healy: Does anybody have that right?

Mr. Browning: Yes, sir.

Commissioner Healy: Who?

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Mr. Browning: North American. We submit that it is clearly the company's right, if one must be designated.

Commissioner Healy: Why don't you exercise it?

Mr. Browning: We submit that we have the right to designate it, and that if you disagree with our argument, our primary argument—which is that we don't have to designate—and you hold against us, then we submit that we have

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9671 the right to designate as soon as you call upon us.

Commissioner Healy: You are not ready to do it now?

Mr. Browning: At this moment, no. If the Commission tells me that we must, we will do it immediately.

Commissioner Healy: Well, my trouble, frankly, is that I get into difficulty with this word "additional". First the statute says that the holding company must reduce itself to the ownership of one integrated system. Then it says it can keep "additional" systems. That implies additional to something. What can it be additional to?

9672 Mr. Browning: On the facts of this case we contend that each of the three clearly qualifies on the tests for secondary systems.

Commissioner Healy: Well, what are they additional to?

Mr. Browning: To the third, which is primary. You have here just three systems. We have shown that each of the systems meets the tests. Now then, since each of the systems meets the tests, there is no reason why either you or we have to face the problem of which is principal.

Commissioner Healy: Now you say they meet the tests?

Mr. Browning: Yes, sir.

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Charles S. Hamilton, Jr.*

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Commissioner Healy: They meet the tests applicable to additional systems in your contention?

Mr. Browning: Yes, sir; they have been conceded to meet the primary tests.

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Commissioner Healy: Additional to what?

Mr. Browning: Additional each to any one of the others, except that under the (B) standard, either Cleveland or Union is required to be the principal system. I think we can work it down to that.

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But we submit that if you do reject our views, that North American alone has that right to designate, and we are ready to designate immediately.

Commissioner Healy: How immediately?

Mr. Browning: Pretty immediately, Judge.

Commissioner Healy: Not today at least, is that right?

Mr. Browning: I should prefer—if you insist, I will.

Commissioner Healy: I am not proposing that.

Mr. Browning: I am prepared to do so if the Commission requires it, but I submit that we are entitled to consideration of that argument, and in our brief—

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Commissioner Healy: (Interposing) Suppose we don't put it in too formal terms. Would you be willing to guess as to which one of these systems, North American might designate as the principal single integrated system if we held against you on the question of statutory construction?

Mr. Browning: Do you want my guess, Judge?

Commissioner Healy: Yes.

Chairman Eicher: Educated guess.

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Charles S. Hamilton, Jr.*

Mr. Browning: If we are required to elect, we elect Union, but I submit that we are not required to elect, and that any order which is issued, if it overrules our contentions that we are entitled to maintain all the systems, should be in the alternative. This Commission, I may state, in its Commonwealth & Southern tentative order, has dealt with alternatives, and I thought very clearly.

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Commissioner Healy: What do you think Union includes?

Mr. Browning: It is conceded to be a single integrated system.

Commissioner Healy: Does it include the Illinois-Iowa Power Company?

Mr. Browning: Oh no, Judge. It is the Union Electric Company of Missouri and its subsidiaries.

Commissioner Healy: That includes the Mississippi River Power Company, for example?

Mr. Browning: That is right.

Commissioner Healy: And it includes the Union Electric Company of Illinois?

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Mr. Browning: That is right. And it is our position that it also includes St. Louis County Gas Company.

In conclusion, may we say that North American has had a long and honorable history. For over 50 years it has held a high place in the United States. It started with the beginning of the electrical business. It has developed these fine operating companies which have rendered outstanding service to the public, their consumers and investors.

We ask you to consider the achievements of the four operating groups. Does anyone think that it is an accident that

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each of our operating groups holds the position that it does in the utility industry? Is anyone as naive as to think that it is a coincidence that Washington, Cleveland, Milwaukee and St. Louis hold their outstanding positions? You read just this past week a statement by Secretary Ickes concerning a possible power shortage, and probable measures which would have to be taken. There is no power-shortage in the North American subsidiaries. Nobody in those cities is going to have to cut down his consumption of current. There will be no shortage whatever. Why? Because those subsidiaries started two years ago to build facilities to meet this emergency. In other words, they looked ahead and they had long-range planning, and that is characteristic of North American's subsidiaries.

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North American has a great achievement in that its

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policies and aid have developed these subsidiaries. We are proud of them and of what North American has done.

Now on various occasions here, members of your very courteous staff have said to me, in substance, "Remember, we did not write this law, but we are here to enforce it, and it is our duty to enforce it; in other words, if North American is to be dismembered, it will not be the fault of the staff or of the Commission or of Congress, the law requires it."

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Now in all frankness, that state of mind represents an unconscious effort to evade responsibility. Unfair and destructive as this statute is, its framers still left to this Commission sufficient room for it to preserve the fundamental structure of The North American Company through the combination of the three systems. The Commission needs

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not strain to reach the result. Even a fair construction of the Act permits it. It is only if the statute is distorted, rewritten by the legislative efforts of the staff itself, that North American will be dismembered.

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So we submit to you that this case is now the very grave responsibility of this Commission. It is now your problem whether you will tear apart and dismember a great and distinguished company, destroying something fine and valuable; or whether, administering justice with economic statesmanship, you will apply this law so as to preserve The North American Company, permitting it to continue its distinguished contributions to this accomplished age.

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Commissioner Healy: I presume as a lawyer you believe in the supremacy of law in the United States?

Mr. Browning: Yes, Judge, I do.

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Commissioner Healy: Do you believe what the unanimous Supreme Court, speaking of the Federal Trade Commission—another independent commission—said, that such commissions had no right to have any policy except the policy of the law?

Mr. Browning: Yes, sir. My difficulty, Judge, in the construction of this statute, is that I think you have gone beyond that point.

Commissioner Healy: Well, of course, that is a question that will have to be settled by the courts ultimately, will it not?

Mr. Browning: You have concededly not followed its literal meaning.

Commissioner Healy: Who has conceded that?

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Charles S. Hamilton, Jr.*

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Mr. Browning: I mean that Standard (B) was rewritten, so far as I know, in the U.G.I. case.

Commissioner Healy: I don't think that that is so at all.

Mr. Browning: Well, perhaps it might be differently phrased.

Commissioner Healy: Of course, you could say that of any statute, or of a will, or a deed, or any legal document. Of course, we have to concede that the last word on the construction of a statute lies in the courts.

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Mr. Browning: Yes, sir.

Commissioner Healy: That is entirely proper, and that is consistent with the supremacy of law in the United States, and we construe these statutes as well as we can, as lawyers. You do the same thing, and so do the judges of the courts.

Under your statement of reducing these issues to three systems, why shouldn't this Commission forthwith issue an order requiring you to divest yourself of everything outside of the three systems?

Mr. Browning: Our position on that is that first, while we know the Commission has already passed on the point in another proceeding, that such an order is not warranted by the statute; but over and above that, we cannot see what possible purpose it would serve here.

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As you know, all steps are being taken which North American can take to dispose of these other interests. Of course, it is our fundamental position that you constitutionally cannot do it, so we cannot consent to any such order.

I can't see what possible practical good it would do.

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Rebuttal Argument of Ralph C. Binford

As you know, North American is pretty close to the mark on this Washington thing. We think it would hurt the situation and not help it.

Chairman Eicher: Mr. Binford, have you any reply?

Mr. Binford: Yes.

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Rebuttal Argument of Ralph C. Binford:

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Mr. Binford: I wish to state that my incorrect statement relative to the investment of North American Company in Detroit Edison was wholly inadvertent. I didn't intend it as an exaggeration for effect or otherwise.

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In the requested findings of fact filed by counsel for the Commission, it is requested that the Commission find that as of December 31, 1940, the investment of The North American Company in the Detroit Edison Company amounted to \$29,822,316, which is taken from the exhibit of the respondent in this case. My figure of \$40,000,000 was inadvertently stated, it was not an attempt at exaggeration. As of the same date, the investment of The North American Company in Pacific Gas & Electric Company was carried upon the books of The North American Company at \$63,765,419.

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For the general purpose for which these figures were given, namely to show the enormous magnitude of this system, such a discrepancy in figures has no particular meaning.

Now, on the question of the meaning of the words and phrases, such other businesses as are "reasonably incidental or economically necessary or appropriate to the operations" of such integrated public utility system, counsel for respondents state that we have not been specific in our argument, and

that the word "incidental" has numerous meanings other than functionally related.

I concede that the word "incidental" does have other meanings. The dictionary gives a number, such as casual, or things occurring perchance. However, we submit, as used in this section, with reference to the powers which a holding company will be permitted to exercise, and the field of the exercise of those powers, our nearest analogy for the use of the word "incidental", particularly when the word is preceded by the adverb "reasonably", is that there is some functional attribute to be given to the word, and we proceeded upon that basis, and we think that the words used together, or in the manner in which the several phrases are used here "reasonably incidental, or economically necessary or appropriate", they take some degree of color from each other, and regard it as having meaning within a somewhat similar field.

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As to the specific properties involved here, the coal company, the transportation properties, the office building which

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houses the Hanover Bank and The North American Company only—possibly I might in a different sense say—incidentally, and the North American Securities Corporation, it seems to us evident that there is no way in which it can be said with any degree of reason that the retention of this office building in the heart of the financial district of New York is "reasonably incidental or economically necessary or appropriate to the operations" of the electric utility system in Cleveland, Ohio, or to the one in Wisconsin and Michigan, or to the one in St. Louis; and if it is not "reasonably incidental" to the operations of any one of these three, it is not retainable under the terms of the Act.

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Rebuttal Argument of Ralph C. Binford

The same thing is true as to the coal mining properties, which do not furnish coal to the utilities here in question, namely those of the West Kentucky Coal Company. It was suggested that when they were purchased some 30 years ago, it was thought that these coal properties might be used as a source of supply for the Union Electric of Missouri companies, but they never have been so used to any degree.

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Counsel also, I believe, misunderstood my statement relative to the Florida Case, which I cited, which case, by the way, is not unusual under numerous authorities cited in it—and there was a key number given in the digest showing a long line of cases to the same effect. His understanding was that the later general law regulating banks, which was held

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to govern over the provisions of a prior charter by special act of the legislature, expressly repealed that special act. That is not true in this case. I possibly did not make the statement clearly enough. But the general act in that case, just as in the present case, related to an industry or a field of business activity, as a whole, without specific reference to any special charter or other special laws theretofore enacted, and it was held that the general regulation prevailed over the apparent charter powers.

Getting to the question of the retention of these several systems by The North American Company, under the (A), (B) and (C) standards of section 11(b)(1), it is again argued by counsel for the respondent that our argument is too general. They speak of the benefits supposed to accrue by reason of advice from The North American Company; financial assistance from The North American Company, by way, however, apparently of advice rather than of contribu-

tions in the main; and thirdly, of the intercompany relationships through the several committees.

Now, I think there may be some benefits which are intangible, possibly, as counsel suggested.

The words of paragraph (A) are these:

"Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system."

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The only economies that I see in this argument that are relied upon are only called such by stretching the meaning of the word. They are the supposed benefits which have not been calculated in dollars and cents, or in actual degrees of efficiency, related to the so-called benefits, which these several companies receive by reason of their contacts with the personnel of The North American Company.

It isn't a dollars and cents proposition. It isn't like a case where you have several small companies in one State or an adjoining State, where there are economies in purchasing or economies that can be measured in any pecuniary or any other sense, other than emotionally.

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Now, we don't know, as far as the record shows, whether the financing that a certain company of the North American system did at a certain time, was solely by reason of advice received from the several financial experts of The North American Company, and resulted in substantial savings, or whether they would not have done it anyhow, in the absence of such advice.

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The benefits supposed to accrue from the exchange of information through these so-called inter-company com-

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Rebuttal Argument of Ralph C. Binford

mittees, which are three in number, the station operating advisory committee, composed of mechanical engineers; the electric committee, composed of electrical engineers; and the accounting committee, composed of accountants of the several companies—were not apparently fully realized until this present 11(b)(1) proceeding was begun, because up until that time only two of these committees existed. Then, after these proceedings were started, it was suddenly recognized that the idea of having the engineers meet four or five times a year in regular meeting, might be a good one to carry a little further, and have the accountants do likewise.

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At the time mention was first made of the accounting committee in this proceeding, it only had had one meeting, and that was an organization meeting.

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These other committees have functioned over a long period of years, and there probably is quite a little benefit to be obtained by the exchange of information. But we respectfully submit that these three things—first, general advice from the executives of the holding company to the operating companies; secondly, the intervention to the benefit or detriment (we don't know which) of the operating companies, of the holding company's financial man in the financing of the operating companies; and third, the sponsorship by the holding company of the exchange of technical in-

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formation between the companies—falls far short of showing that each of such additional systems can not be operated as an independent system without “the loss of substantial economies”.

Now as to localized management, under (C) there is quite a degree of localized management, except in financial mat-

ters, among these several North American companies, and I think there is quite a showing of efficient operation.

On the other hand, "the continued combination of such systems under the control of such holding company," has not been proven, and the burden of proof is upon the respondent, not to be "so large, considering the state of the art and the area or region affected, as to impair the advantages of localized management" in another sense, which I will mention, or the effectiveness of regulation.

Counsel for the respondents accuses me of making a slurring reference to recent happenings in the Union Electric Company of Missouri system. The reference wasn't intended as a slur, but rather as an avoidance by merely referring to the matter, of detailed argument, to show that the existence of the situation which developed in Union Electric Company of Missouri, and with which this Commission is familiar, and which is shown in part in the record in this case, obviously indicates, if The North American Company officials were wholly ignorant and innocent of the matters that arose in that system, and if the state authorities were unable to

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detect the matter until the point of indictment had been reached, and the point of a lawsuit for the purpose of forfeiting the charter of the Union Electric Company of Missouri had been reached—that this system, as presently constituted is getting so large as to get out of hand of eight officers and 99 employees of The North American Company located in New York. In other words, the effectiveness of regulation isn't demonstrated by the incidents in connection with that Union Electric of Missouri situation.

Now on the question of size, it is suggested that we have conceded that the Kansas Power & Light Company, in so

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Rebuttal Argument of Ralph C. Binford

far as its electric utility operations and properties are concerned—this company being a subsidiary of North American Light & Power Company—constitutes a single integrated system, while its geographic extent in square mile area is greater than that of the three systems presently sought to be retained by The North American Company.

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We don't think that is inconsistent at all. In the Kansas situation we have an entirely different area or region. It is a rural area, with great distances between centers of population, and there are no large centers of population in the area.

Consequently, in a sparsely settled rural section such as that, a system, to be operated at maximum efficiency, may be larger in square mile area than one in a metropolitan district or area such as Cleveland, Washington or the St. Louis metropolitan area.

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The statute specifically enjoins the Commission to look to the particular area or region affected.

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So we see no inconsistency in that position that any two of these systems, or the three put together, which lie within The North American Company system, proper, would be too big a combination to meet the several tests of (C).

Now as to (B), by the adoption of the briefs in these other proceedings, which has been done here at the request of counsel for the respondent, the necessity of arguing (B) and the proper interpretation thereof, appears to be made unnecessary except in this respect.

Counsel for the Commission do not, of course, accept the interpretation suggested by counsel for the respondent that the word "adjoining" is a transitory word that would cover a string of systems extending all the way around the United States and eventually over the United States, merely because

each additional system may have properties in a state adjoining the next additional system in the chain.

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Now we insist that the word "adjoining" relates to the State in which the principal system is situated, of course.

I think the other points have been covered as fully as is practicable in a matter of this kind, in the briefs which have been filed.

Mr. Browning: Could I give Judge Healy the figures he asked for?

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Chairman Eicher: Yes.

Mr. Browning: Judge, you asked whether North American had invested any equity capital in the Wisconsin group.

Commissioner Healy: That wasn't my question, but it is all right to answer it as if I had asked it.

Mr. Browning: A rough check shows \$24,400,000 for that group alone, and our findings give a figure of \$104,000,000 for the four groups.

Commissioner Healy: Of course, when The North American Company advised the Wisconsin Company to finance a generating addition through the issuance of bonds, it may have been acting primarily in its own interest, for all I know; as the owner of the equity, The North American Company would have the benefit of the leverage of the money invested by way of bonds.

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If you had a three or four or five per cent. coupon on the bonds, and the rate of return permitted by the State Commission at that time was 7 or 8 per cent., the common stock would have the benefit of the amount by which the rate of return exceeded the cost of that money invested to produce that return; isn't that true?

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Rebuttal Argument of Ralph C. Binford

Mr. Browning: It certainly is true that the issuance of senior securities at a lower rate increases the rate of return.

Could I say on that, Judge, that we are proud of our financial record and we hope you are going to read the briefs in which we discuss it.

Commissioner Healy: Of course we will read the briefs.

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Mr. Browning: We are proud of our capitalization, we are proud of our financing. One of the things we have pointed out is that there has never been a default on a security in these groups. You know what a remarkable record that is.

One other minor matter which Mr. Binford and I agreed might go into the record.

One of the companies in the Union group had been dissolved, and all of its assets sold or distributed, and Commission counsel was not aware of the fact because the dissolution took place after the record closed.

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I have furnished him with an affidavit by Mr. Woodbridge, and I wonder if we couldn't have that stipulated in as part of the record, or perhaps as an additional exhibit, because then it gets rid of that company, and you don't have to consider it?

Chairman Eicher: Is there any objection, Mr. Binford?

Mr. Binford: No, that is satisfactory.

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Commissioner Healy: What is the name of the company?

Mr. Browning: St. Louis & Alton Railway Company.

Commissioner Healy: Is it a wholly-owned subsidiary?

Mr. Browning: Yes, sir.

Chairman Eicher: The Commission will take the matter under advisement.

(Whereupon, at 5:30 o'clock p. m., the Commission took the above matter under advisement.)

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